HIGHLIGHTS: BY THE NUMBERS

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	Change	**2012**	2011	Change
(000s, except per share amounts)	*($)*	*($)*	*(%)*	*($)*	*($)*	*(%)*
Financial						
Oil and natural gas revenues	**24,020**	9,440	154	**56,734**	20,874	172
Funds from operations (1)	**14,265**	3,795	276	**29,858**	7,739	286
Per share – basic	**0.21**	0.06	250	**0.45**	0.14	221
Per share – diluted	**0.20**	0.06	233	**0.42**	0.14	200
Cash flow from operating activities	**12,555**	8,910	41	**31,315**	6,346	393
Net income (loss)	**1,294**	(353)	467	**3,698**	(3,243)	214
Per share – basic	**0.02**	(0.01)	300	**0.06**	(0.06)	200
Per share – diluted	**0.02**	(0.01)	300	**0.05**	(0.06)	183
Capital expenditures (2)	**33,205**	25,009	33	**99,619**	167,028	(40)
Working capital deficit (3)	**69,698**	3,356	1,977	**69,698**	3,356	1,977
Shareholders' equity	**187,308**	176,346	6	**187,308**	176,346	6
(000s)	*(#)*	*(#)*	*(%)*	*(#)*	*(#)*	*(%)*
Share Data						
At period-end	**67,036**	63,152	6	**67,036**	63,152	6
Weighted average – basic	**66,995**	63,064	6	**65,772**	54,134	22
Weighted average – diluted	**72,792**	63,064	15	**70,591**	54,134	30
			(%)			*(%)*
Operating (4)						
Production						
Natural gas *(mcf/d)*	**8,883**	8,167	9	**8,743**	6,724	30
Crude oil *(bbls/d)*	**2,953**	597	395	**2,123**	427	397
NGLs *(bbls/d)*	**259**	177	46	**269**	129	109
Total *(boe/d)*	**4,692**	2,135	120	**3,849**	1,677	130
Average wellhead prices						
Natural gas *($/mcf)*	**2.38**	3.82	(38)	**2.20**	3.82	(42)
Crude oil and NGLs *($/bbl)*	**74.62**	91.49	(18)	**78.36**	90.90	(14)
Total *($/boe)*	**55.65**	48.05	16	**53.79**	45.59	18
Netbacks						
Operating netback *($/boe)*	**35.18**	22.36	57	**30.98**	23.76	30
Funds flow netback *($/boe)*	**32.98**	19.21	72	**28.23**	16.84	68
Gross (net) wells drilled						
Oil *(#)*	**5 (5.0)**	3 (2.8)	67 (79)	**20 (18.9)**	7 (6.8)	186 (178)
Standing *(#)*	**–**	5 (3.8)	–	**2 (2.0)**	5 (3.8)	-60 (-47)
Dry and abandoned *(#)*	**–**	1 (1.0)	–	**–**	1 (1.0)	–
Total *(#)*	**5 (5.0)**	9 (7.6)	-44 (-34)	**22 (20.9)**	13 (11.6)	69 (80)
Average working interest *(%)*	**100**	84	19	**95**	89	7

(1) Funds from operations and funds from operations per share are not recognized measures under International Financial Reporting Standards ("IFRS"). Refer to the commentary in the Management's Discussion and Analysis under the heading "Non-IFRS Measurements" for further discussion.

(2) Total capital expenditures, including acquisitions and excluding non-cash transactions. Refer to commentary in the Management's Discussion and Analysis under the heading "Capital Expenditures and Acquisitions" for further information.

(3) Current assets less current liabilities, excluding current derivative financial instruments.

(4) For a description of the boe conversion ratio, refer to the commentary in the Management's Discussion and Analysis under the heading "Other Measurements".

LETTER TO SHAREHOLDERS

We are very pleased to report our financial and operating results for the three and nine months ended September 30, 2012. This marks the fourth consecutive quarter of production growth for the Company. This quarter also highlights the fourth consecutive quarter of increased crude oil and NGL growth for the Company, achieving almost 70% crude oil and NGL volumes throughout the third quarter of this year.

Company Highlights:

- The Company achieved record production for the third quarter averaging 4,692 boe/d (68% oil and NGLs and 32% natural gas), an increase of 120% over the same quarter of 2011 and a 23% increase over the second quarter of 2012.
- Increased oil and NGL production to 3,212 bbls/d, a 315% increase over the same period last year and a 36% increase over the previous quarter.
- Funds flow from operations grew to $14.3 million, representing a 276% increase from the third quarter of 2011 and a 45% improvement from the second quarter of 2012.
- Funds from operations on a per share basis increased to $0.21, up 250% from the same quarter last year and 40% from the previous quarter of this year.
- Decreased operating costs to $9.83/boe from $15.26/boe in the same quarter last year and $10.95/boe last quarter.
- Increased operating netback to $35.18/boe from $22.36/boe in the same quarter last year and $30.86/boe in the second quarter of 2012,an increase of 57% and 14%, respectively.
- Invested $33.2 million in capital expenditures which included the drilling of 5 (5.0 net) wells, achieving 100% success rate.
- Finalized the new credit facility with a syndicate of two new banks for $90 million, an increase of $30 million.
- Exited the quarter with total net debt of $70.0 million. This represents a debt to annualized cash flow ratio of 1.2:1.

Operational update

Continued success in the Company's Alberta Bakken and Belly River light oil resource plays has driven another quarter of substantial production growth. Subsequent to quarter end, the Company tied in and brought on-stream 3.0 (3.0 net) wells. Production over the past two weeks averaged 5,750 boe/d (71% oil and NGLs) with an additional 7.0 (6.9 net) wells to be brought on-stream prior to year end. The Company is currently operating one drilling rig in each core area and is presently drilling the Company's sixteenth Alberta Bakken and eighth Belly River wells of 2012 substantially completing our planned capital drilling program.

Bakken

DeeThree had a very active third quarter drilling program on its Ferguson Alberta Bakken property drilling 5.0 gross (5.0 net) wells. The quarter was highlighted by two wells testing 1,025 bbl/d and 743 bbl/d over a ten and nine day test, respectively with these two wells to come on-stream shortly. The Company is pleased to report that initial production and well declines continue to perform substantially better than the type curve used for internal budgeting purposes being an initial production rate of 300 boe/d with a 65% first year decline rate. The following chart illustrates the results of our Bakken drilling program to date and the initial production ("IP") rates versus our internally generated type curve. These results are based on hours on production and include sales from initial flow tests.

IP	DeeThree wells	300 bbl/d type curve	# of wells
30 days	424	300	8
60 days	367	287	7
90 days	348	275	6

The Company has continued to evaluate the historical production and decline curves from its previously drilled wells to determine optimum drill and complete techniques. Early production results indicate that longer horizontal legs exhibit the following characteristics: higher flow rates, higher initial production and flatter decline curves. The Company plans to integrate these findings on a go forward development basis. We are pleased to report that drilling and completion costs have continued to trend downward throughout the year with three of the past four one mile long lateral wells costing approximately $3.0 million.

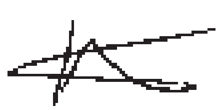
Belly River

DeeThree did not operate a drilling rig on its Belly River light oil property in the third quarter as it focused on drilling and delineating its Alberta Bakken play. Currently the Company has one drilling rig operating in the area drilling its second well of a planned two well fourth quarter program. This fourth quarter drilling program plans to test the fourth distinct sand in this multi-zone play before year end. The Company looks forward to updating these results in the future.

Outlook

Subsequent to the quarter end, the Company successfully closed an equity issue raising net proceeds of approximately $21 million. With the completion of a significant increase to our credit facility and an equity financing in recent weeks, the Company is well positioned to deliver strong growth throughout the final quarter of 2012 and beyond. The Company intends to increase its 2012 capital budget by approximately $30 million to $140 million in total. By year end, the Company will have drilled 16.0 gross (16.0 net) Bakken wells, 8 gross (7.5 net) Belly River wells, 4.0 gross (4.0 net) Sunburst wells and one gross (0.3 net) non-operated well in the Rycroft area. The Company remains on target to reach its exit guidance of 6,000 boe/d by year end. We look forward to reporting the results of our final quarter of 2012.

On behalf of the Board of Directors,



Martin Cheyne
President & Chief Executive Officer

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis ("MD&A") of financial condition and results of operations for DeeThree Exploration Ltd. ("DeeThree" or the "Company") is dated November 13, 2012 and should be read in conjunction with the Company's unaudited interim financial statements and related notes for the three and nine months ended September 30, 2012 as well as the audited financial statements and notes for the year ended December 31, 2011. The interim financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

Additional information regarding the Company and factors that could affect the Company's operations and financial results are included in reports on file with Canadian securities regulatory authorities, including the Company's Annual Information Form, and may be accessed through the SEDAR website (www.sedar.com), or at the Company's website (www.deethree.ca). Furthermore, the forward-looking statements contained in this MD&A are made as of the date of this MD&A and the Company does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise, accept as may be required by applicable securities laws. The Company's forward-looking statements are expressly qualified in their entirety by this cautionary statement.

Non-IFRS Measurements

This MD&A contains the terms "funds from (used in) operations" and "funds from (used in) operations per share", which should not be considered an alternative to or more meaningful than cash flow from (used in) operating activities as determined in accordance with IFRS. These terms do not have any standardized meaning as prescribed by IFRS. DeeThree's determination of funds from (used in) operations and funds from (used in) operations per share may not be comparable to that reported by other companies. Management uses funds from (used in) operations to analyze operating performance and leverage, and considers funds from (used in) operations to be a key measure as it demonstrates the Company's ability to generate cash necessary to fund future capital investments and to repay debt, if applicable. Funds from (used in) operations is calculated using cash flow from (used in) operating activities as presented in the statement of cash flows before changes in non-cash working capital. DeeThree presents funds from (used in) operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of earnings per share.

The following table reconciles funds from operations to cash flow from operating activities, which is the most directly comparable measure calculated in accordance with IFRS:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Cash flow from operating activities	**12,555**	8,910	**31,315**	6,346
Changes in non-cash working capital	**1,710**	(5,115)	**(1,457)**	1,393
Funds from operations	**14,265**	3,795	**29,858**	7,739

During the three and nine months ended September 30, 2012, the Company's funds from operations totaled $14,265,000 ($0.21 per basic share and $0.20 per diluted share) and $29,858,000 ($0.45 per basic share and $0.42 per diluted share), respectively, versus $3,795,000 ($0.06 per basic and diluted share) and $7,739,000 ($0.14 per basic and diluted share) in the respective periods of 2011.

The Company considers corporate netbacks to be a key measure as they demonstrate DeeThree's profitability relative to current commodity prices. Corporate netbacks are comprised of operating, funds flow and net income (loss) netbacks. Operating netback is calculated as the average sales price of its commodities and then subtracts royalties, operating costs and transportation expenses. Funds flow netback starts with the operating netback and further deducts general and administrative costs, finance expense and adds finance income as well as realized gains on financial instruments. To calculate the net income (loss) netback, DeeThree takes the funds flow netback and deducts share-based compensation expense as well as depletion and depreciation charges, accretion expense, unrealized gains or losses on financial instruments, any impairment or exploration and evaluation expense and deferred income taxes. There is no IFRS measure that is reasonably comparable to netbacks. See the section entitled "Netbacks (per unit)" for the netback calculations.

Net debt and working capital deficit, which represent current assets less current liabilities, excluding current derivative financial instruments, are used to assess efficiency, liquidity and the general financial strength of the Company. There is no IFRS measure that is reasonably comparable to net debt or working capital deficit.

Other Measurements

All dollar amounts quoted are in Canadian dollars. Where amounts are expressed on a barrel of oil equivalent ("boe") basis, natural gas volumes have been converted to oil equivalence at six thousand cubic feet of gas to one barrel of oil. This conversion ratio of 6:1 is based on an energy equivalent conversion for the individual products, primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Such disclosure of boes may be misleading, particularly if used in isolation. Readers should be aware that historical results are not necessarily indicative of future performance.

Forward-Looking Statements

Certain statements contained in this MD&A may constitute forward-looking statements. These statements relate to future events or the Company's future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Company believes that the expectations reflected in those forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon by investors. These statements speak only as at the date of this MD&A and are expressly qualified, in their entirety, by this cautionary statement.

In particular, this MD&A contains forward-looking statements pertaining to the following: projections of market prices and costs, supply and demand for natural gas and crude oil, the quantity of reserves, natural gas and crude oil production levels, capital expenditure programs, treatment under governmental regulatory and taxation regimes, and expectations regarding the Company's ability to raise capital and to continually add to reserves through acquisitions and development.

With respect to forward-looking statements contained in this MD&A, the Company has made assumptions regarding, among other things, the legislative and regulatory environments of the jurisdictions where the Company carries on business or has operations, the impact of increasing competition and the Company's ability to obtain additional financing on satisfactory terms.

The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors included in this MD&A such as: volatility in the market prices for natural gas and crude oil; uncertainties associated with estimating reserves; geological, technical, drilling and processing problems; liabilities and risks, including environmental liabilities and risks inherent in natural gas and crude oil operations; incorrect assessments of the value of acquisitions; and, competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel. In addition, test results are not necessarily indicative of long-term performance or of ultimate recovery.

This forward-looking information represents the Company's views as at the date of this MD&A and such information should not be relied upon as representing its views as of any date subsequent to the date of this MD&A. DeeThree has attempted to identify important factors that could cause actual results, performance or achievements to vary from those current expectations or estimates expressed or implied by the forward-looking information. However, there may be other factors that cause results, performance or achievements not to be as expected or estimated and that could cause actual results, performance or achievements to differ materially from current expectations. There can be no assurance that forward-looking information will prove to be accurate, as results and future events could differ materially from those expected or estimated in such statements. Accordingly, readers should not place undue reliance on forward-looking information. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as expressly required by applicable securities legislation.

Description of the Company

DeeThree is a Calgary based resource company actively engaged in light crude oil and natural gas exploration, development and production in key areas of the Western Canadian Sedimentary Basin. DeeThree commenced operations in 2007 as a private company focused on creating long-term shareholder value through prudent operational and financial management.

DeeThree has created a platform for growth through a sound business strategy that includes low risk development and exploration as well as strategic acquisitions. The Company has three core operating areas: the Peace River Arch area of northwestern Alberta as well as the Brazeau area of west central Alberta, which are prospective for light crude oil, natural gas and natural gas liquids, and the Lethbridge area of southern Alberta, which features shallow gas and Bakken light oil. These three areas have provided the Company with a balanced and diverse production base.

Common shares of DeeThree are listed for trading on the Toronto Stock Exchange under the symbol DTX and the United States OTCQX under the symbol DTHRF.

In late 2008, DeeThree completed its first significant acquisition from a major oil and gas producer of properties in the Lethbridge area of southern Alberta (the "Lethbridge property"). The Lethbridge property was the primary focus of the Company until late in the first quarter of 2011 when DeeThree closed a transformational acquisition of properties in the Peace River Arch and Brazeau areas (the "Peace River Arch and Brazeau properties"). In this acquisition, which closed on March 22, 2011 (effective January 1, 2011), the Company acquired approximately 1,830 boe/d (40% light crude oil and NGLS) of primarily high working interest, operated crude oil, natural gas and NGLs production and reserves.

First Quarter 2012 Transactions

In February 2012, the Company received payment of $1,000,000 as proceeds from the default on a farm-out agreement entered into during 2011. Details of the farm-out are included in the December 31, 2011 MD&A.

On March 27, 2012, the Company issued 3,834,100 flow-through shares at a price of $4.50 per flow-through share for total gross proceeds of $17,253,450 ($16,012,450 net of estimated share issue expenses), including 500,100 flow-through shares ($2,250,450) issued on the exercise in full of the underwriters' over-allotment option. The proceeds of the flow-through share offering will be used to conduct exploration activity on the Company's properties.

Second Quarter 2012 Transactions

In April 2012, the Company's lender approved an increase to the Company's existing credit facility from $50,000,000 to $60,000,000.

Third Quarter 2012 Transactions

There were no significant transactions during the quarter ended September 30, 2012.

Subsequent Events

In October 2012, the Company completed the funding of a new $90,000,000 revolving demand credit facility (the "New Credit Facility"). The New Credit Facility is provided by a syndicate of two new lenders replacing and paying out DeeThree's previously existing revolving demand credit facility.

On October 4, 2012, the Company executed a purchase and sale agreement with a private oil and gas company pursuant to which DeeThree acquired interests in producing assets in the Brazeau Belly River area for cash consideration of $7,000,000 subject to certain adjustments.

On October 18, 2012, the Company issued 3,139,500 common shares at a price of $5.50 per common share, including 409,500 common shares ($2,252,250) issued on the exercise in full of the underwriters' over-allotment option and 770,000 flow-through shares at a price of $6.50 per flow-through share for total gross proceeds of $22,272,250 ($20,800,000 net of estimated share issue expenses). The proceeds of the share offering will be used to conduct development and exploration activity on the Company's Belly River formations on its lands in its Brazeau area as well as additional Alberta Bakken targets on the Lethbridge Property.

Financial and Operating Results

Sales Volumes

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
Sales				
Natural gas *(mcf/d)*	**8,883**	8,167	**8,743**	6,724
Crude oil *(bbls/d)*	**2,953**	597	**2,123**	427
NGLs *(bbls/d)*	**259**	177	**269**	129
Total sales *(boe/d)*	**4,692**	2,135	**3,849**	1,677
	(%)	*(%)*	*(%)*	*(%)*
Production Split				
Natural gas	**32**	64	**38**	67
Crude oil	**62**	28	**55**	25
NGLs	**6**	8	**7**	8
Total	**100**	100	**100**	100

For the third quarter of 2012, the Company's production averaged 4,692 boe/d compared to 2,135 boe/d in the same period of 2011 and 3,805 boe/d recorded in the second quarter of 2012. This represents a 120% year-over-year and 23% quarter-over-quarter increase. These increases were directly attributed to the Company's drilling success.

For the first nine months of 2012, DeeThree's production averaged 3,849 boe/d compared to 1,677 boe/d a year ago, representing a 130% increase. During the 2012 nine-month period, production was comprised of 8,743 mcf/d of natural gas, 2,123 bbls/d of crude oil and 269 bbls/d of NGLs, thereby increasing the Company's crude oil and NGLs production to 62% of total corporate production versus 33% in the comparable period of 2011.

Revenue

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Natural gas	**1,947**	2,869	**5,278**	7,015
Crude oil	**20,708**	5,094	**46,755**	10,934
NGLs and other	**1,365**	1,477	**4,701**	2,925
Total oil and natural gas revenue	**24,020**	9,440	**56,734**	20,874

During the three months ended September 30, 2012, revenue increased 154% to $24,020,000 from $9,440,000 recorded in the comparative period of 2011 and rose 30% from $18,437,000 in the second quarter of 2012. These increases were a result of increased production, as explained in the "Sales Volumes" section above, compounded by a change to a higher percentage of oil and NGLs (69% vs. 36%) and the resulting increase in corporate average price per boe.

For the first nine months of 2012, revenue totaled $56,734,000 versus $20,874,000 for the same period of 2011. Total revenue increased 172% compared to 2011 primarily as a result of the 130% year-over-year increase in sales volumes.

Commodity Prices and Foreign Exchange

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
	($)	*($)*	*($)*	*($)*
Benchmark Prices				
Natural gas				
NYMEX *(US$/mmbtu)* (1)	**2.81**	4.19	**2.62**	4.23
AECO *(CDN$/GJ)* (2)	**2.17**	3.47	**2.00**	3.57
Crude oil				
WTI *(US$/bbl)*	**92.22**	89.76	**96.21**	95.48
Edmonton light *(CDN$/boe)*	**84.57**	91.93	**87.08**	94.43
Average Realized Prices				
Natural gas *($/mcf)*	**2.38**	3.82	**2.20**	3.82
Crude oil *($/bbl)*	**76.22**	92.76	**80.37**	94.52
NGLs *($/bbl)*	**56.35**	87.23	**62.48**	78.87
Total sales price *($/boe)*	**55.65**	48.05	**53.79**	45.59
Foreign Exchange				
CDN$/US$	**0.9948**	0.9802	**1.0021**	0.9780
US$/CDN$	**1.0053**	1.0202	**0.9979**	1.0225

(1) Mmbtu is the abbreviation for millions of British thermal units. One mcf of natural gas is approximately 1.02 mmbtu.
(2) GJ is the abbreviation for gigajoule. One mcf of natural gas is approximately equal to 1.05 GJ.

The Company's financial results are significantly influenced by fluctuations in commodity prices, including price differentials and foreign exchange rates. The Company seeks to protect itself from fluctuations in prices and exchange rates by maintaining an appropriate hedging strategy. As at the date of this MD&A, DeeThree had nine crude oil hedges in place (see "Risk Management" section below for details), five which were entered into during 2011, two which were entered into during the first quarter of 2012 and another two which were entered into during the quarter ended September 30, 2012. Most commodity prices are based on U.S. dollar benchmarks, which result in the Company's realized prices being influenced by the Canadian/U.S. exchange rates. The Company does not sell or transact in foreign currency, but may be impacted by foreign currency exchange rate changes related to commodity prices as outlined above. As at the date of this MD&A, DeeThree also had three foreign currency exchange risk management contracts in place to mitigate these risks (see "Risk Management" section below for contract details), two of which were entered into during 2011 and one which was entered into during the second quarter of 2012.

During the three-month period ended September 30, 2012, benchmark natural gas prices in Canada fell 37% from the same period last year. In Canada, the benchmark index is the price set at the AECO hub, a major storage site near the TransCanada Energy pipeline exit point from Alberta at Empress. The benchmark index for United States natural gas prices is the market price as established by the New York Mercantile Exchange at Henry Hub ("NYMEX"), a major point of natural gas pipeline intersection in Louisiana. NYMEX is linked to AECO through transportation tariffs from the respective hubs to common markets and through foreign exchange rates. AECO prices averaged $2.17/GJ throughout the third quarter of 2012 compared to $3.47/GJ a year ago and $1.80/GJ in the prior quarter. DeeThree's average realized gas price during the three-month period was $2.38/mcf versus $3.82/mcf last year and $2.06/mcf last quarter.

Oil prices increased slightly in the third quarter of 2012 with West Texas Intermediate ("WTI") averaging $92.22/bbl compared to $89.76/bbl in the same period last year but was slightly down compared to $93.49/bbl in the prior quarter. The benchmark for crude oil prices in North America, and substantially globally, is WTI delivered to Cushing, Oklahoma, again as determined by the NYMEX. Canadian crude prices are based on refiner postings in Canadian dollars at Edmonton, Alberta, and as with natural gas, are linked to WTI through transportation tariffs to common markets and the foreign exchange rate. The average realized price of DeeThree's crude oil was $76.22/bbl for the third quarter of 2012 compared to $92.76/bbl a year ago and $81.21/bbl in the prior quarter. The Company's Bakken crude oil production is of a slightly lower quality than its other core areas, thus attracting a lower wellhead price and resulting in a differential to market prices. As the Company's proportion of Bakken crude increases, this will result in a lower average realized price when compared to the benchmark, as is seen this quarter versus the last two quarters of this year and versus the same quarter of 2011. Information regarding the Company's risk management program can be found in the "Business Risks and Risk Mitigation" section of this MD&A.

Royalties

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Oil and natural gas revenues	**24,020**	9,440	**56,734**	20,874
Total royalties	**3,785**	1,847	**9,935**	3,604
Total royalties *($/boe)*	**8.77**	9.40	**9.42**	7.87
Percent of revenue *(%)*	**16**	20	**18**	17

The Lethbridge property is primarily subject to freehold royalties, which is a sliding scale royalty determined monthly on a well-by-well basis using a calculation that is based on the New Alberta Crown Royalty 2009 with a cap of 30%. The sliding scale varies based on productivity (a higher royalty is payable from wells with higher production rates) and commodity prices (a higher royalty is payable in times of higher natural gas and crude oil prices).

The Peace River Arch and Brazeau properties are primarily subject to Crown royalties payable to the provincial government and overriding royalties on oil, natural gas and NGLs production. These types of royalties are also sensitive to both production levels and commodity prices; therefore, the Company's royalties will continue to fluctuate with commodity prices, well production rates, production declines of existing wells along with performance and location of new wells drilled.

For the third quarter of 2012, royalties totaled $3,785,000 or 16% of revenue compared to $1,847,000 or 20% of revenue for the same quarter in 2011 and $3,413,000 or 19% of revenue in the second quarter of 2012. The year-over-year royalty rate change was primarily due to new production from the Company's wells brought on-stream during the past year, some of which are subject to a freehold royalty based on the New Alberta Crown Royalty 2009, while others qualify for the 5% royalty holiday under the Government of Alberta royalty framework. The decrease in the Company's third quarter royalties as a percentage of revenue was also affected by a prior period adjustment relating to freehold royalties.

During the first nine months of 2012, royalties totaled $9,935,000 or 18% of revenue versus $3,604,000 or 17% of revenue a year ago, which was directly attributable to the increase in the Company's crude oil production, which attracts a higher royalty rate.

Operating and Transportation Expenses

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Operating expenses	**4,243**	2,998	**12,321**	5,774
Transportation expenses	**806**	202	**1,799**	616
Total operating and transportation expenses	**5,049**	3,200	**14,120**	6,390
Operating expenses *($/boe)*	**9.83**	15.26	**11.68**	12.61
Transportation expenses *($/boe)*	**1.87**	1.03	**1.71**	1.35
Total operating and transportation expenses *($/boe)*	**11.70**	16.29	**13.39**	13.96

Operating costs include all costs associated with the production of crude oil and natural gas. The major components of operating costs include charges for contract operating, processing fees, lease rentals, property and pipeline taxes, utilities and well maintenance charges.

Operating expenses for the third quarter of 2012 totaled $4,243,000 or $9.83/boe compared to $2,998,000 or $15.26/boe in the same period last year and $3,790,000 or $10.95/boe in the second quarter of 2012. As production volumes increase, the Company has been able to realize economies of scale in the Lethbridge and Brazeau properties, contributing to a lower operating cost per barrel when compared to the second quarter of 2012.

Transportation expenses for the three months ended September 30, 2012 were $806,000 or $1.87/boe compared to $202,000 or $1.03/boe recorded in the third quarter of 2011 and $548,000 or $1.58/boe in the second quarter of 2012. Transportation expenses reflect NOVA and ATCO transportation costs and fluctuate depending on the proportion of the Company's gas that was flowing on firm service versus interruptible service (interruptible service is slightly more expensive) as well as the proportion of Company volumes on ATCO versus NOVA (ATCO is less expensive). Over the past year, the Company has increased production of both crude oil and NGLs, and the transportation costs associated with those products consist primarily of pipeline tariffs, terminal charges and trucking (crude oil and NGLs attract a higher cost per boe for transportation compared to natural gas).

For the nine months ended September 30, 2012, the Company incurred operating expenses of $12,321,000 or $11.68/boe compared to $5,774,000 or $12.61/boe in the corresponding 2011 period. Transportation expenses for the first nine months of 2012 totaled $1,799,000 or $1.71/boe versus $616,000 or $1.35/boe in the same period last year.

Risk Management

The Company has elected not to use hedge accounting, and accordingly, the fair value of the financial contracts is recorded at each period-end. The fair value may change substantially from period to period depending on commodity and foreign exchange forward strip prices for the financial contracts outstanding at the balance sheet date. The change in fair value from period-end to period-end is reflected in the earnings for that period. As a result, earnings may fluctuate considerably based on the period ending commodity and foreign exchange forward strip prices.

As at September 30, 2012, the Company had the following crude oil and foreign exchange risk management contracts in place with a total mark-to-market asset value of $1,668,000 ($1,398,000 current and $270,000 non-current):

Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price
Jan.1/12 – Dec.31/12	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$95.00/bbl (floor) – US$115.00/bbl (cap) (1)
Jan.1/12 – Dec.31/12	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$85.00/bbl (floor) – US$112.50/bbl (cap) (2)
Jan.1/12 – Dec.31/12	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$90.00/bbl (floor) – US$116.60/bbl (cap) (3)
Jan.1/13 – Dec.31/13	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$85.00/bbl (floor) – US$111.00/bbl (cap) (4)
Jan.1/13 – Dec.31/13	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$90.00/bbl (floor) – US$113.25/bbl (cap) (5)
Jan.1/13 – Dec.31/13	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$90.00/bbl (floor) – US$116.25/bbl (cap) (6)
May 1/12 – Dec.31/13	Crude oil	Collar	250 bbls/d	WTI-NYMEX	US$95.00/bbl (floor) – US$118.00/bbl (cap) (7)
Sept.1/12 – Dec.31/12	Crude Oil	Collar	500 bbls/d	WTI-NYMEX	US$85.00/bbl (floor) – US$104.25/bbl (cap) (8)
Jan.1/13 – Dec. 31/13	Crude Oil	Swap	500 bbls/d	WTI-NYMEX	US$90.00/bbl (floor) – US$106.00/bbl (cap) (9)

(1) Unless the monthly WTI price averages over US$115.00/bbl every day for the entire month, in which case the cap becomes US$100.00/bbl.
(2) Unless the monthly WTI price averages over US$112.50/bbl every day for the entire month, in which case the cap becomes US$95.00/bbl.
(3) Unless the monthly WTI price averages over US$116.60/bbl every day for the entire month, in which case the cap becomes US$95.00/bbl.
(4) Unless the monthly WTI price averages over US$111.00/bbl every day for the entire month, in which case the cap becomes US$90.00/bbl.
(5) Unless the monthly WTI price averages over US$113.25/bbl every day for the entire month, in which case the cap becomes US$92.00/bbl.
(6) Unless the monthly WTI price averages over US$116.25/bbl every day for the entire month, in which case the cap becomes US$92.00/bbl.
(7) Unless the monthly WTI price averages over US$118.00/bbl every day for the entire month, in which case the cap becomes US$100.00/bbl.
(8) Unless the monthly WTI price averages over US$104.25/bbl every day for the entire month, in which case the cap becomes US$90.00/bbl.
(9) Unless the monthly WTI price averages over US$106.00/bbl every day for the entire month, in which case the cap becomes US$90.00/bbl.

Period	Currency	Type of Contract	Quantity	Pricing Point
Jan.1/12 – Dec. 31/12	US$	Average Rate Participating Forward	US$1,400,000	Strike – $1.0275 Fade In – $0.9300 Participating – $1.0800 (1)
Jan.1/12 – Dec.31/13	US$	Average Rate Range Bonus Accumulator	US$700,000	Target – $1.10 CDN$/US$ + $1,000 bonus/day (2)
Jun.1/12 – Dec.31/13	US$	Average Rate Range Bonus Accumulator	US$900,000	Target – $1.0775 CDN$/US$ + $900 bonus/day (3)

(1) If the Bank of Canada average daily noon rate ("average rate") for the month is equal to or greater than the fade in level and equal to or less than the strike, the Company is committed to sell U.S. dollars at the strike price. If the average rate settles greater than the strike and equal to or less than the participating level, no transaction occurs. If the average rate for the month settles above the participating level, the Company is obligated to settle at the strike price and if the average rate settles less than the fade in level, no transaction occurs.

(2) The Company can earn a bonus payout of up to $1,000/day depending on the period in which the exchange rate remains in the applicable range of equal to or greater than $0.9350 and equal to or less than $1.10.

(3) The Company can earn a bonus payout of up to $900/day depending on the period in which the exchange rate remains in the applicable range of equal to or greater than $0.9300 and equal to or less than $1.0775.

These contracts are considered to be financial instruments and the resulting derivative financial asset has been recorded on the Company's statement of financial position, with the unrealized gain or loss being recorded on the statement of operations and comprehensive income (loss).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Unrealized (loss) gain on financial instruments	**(2,540)**	1,921	**2,697**	2,013
Unrealized (loss) gain on financial instruments *($/boe)*	**(5.88)**	9.78	**2.56**	4.40

During the three months and nine months ended September 30, 2012, the Company also realized a gain on these financial instruments as a result of the forward strip prices in relation to the terms of the contracts.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Realized gain on financial instruments	**393**	144	**999**	144
Realized gain on financial instruments *($/boe)*	**0.91**	0.73	**0.95**	0.31

G&A Expense

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Gross G&A expense	**1,437**	1,006	**4,508**	4,010
Capitalized G&A (direct)	**(254)**	(189)	**(1,007)**	(494)
Overhead recoveries	**(402)**	(28)	**(682)**	(112)
G&A expenses (net)	**781**	789	**2,819**	3,404
Transaction costs	**–**	(33)	**–**	(1,158)
G&A expense (net)	**781**	756	**2,819**	2,246
G&A expense (net) *($/boe)*	**1.81**	3.85	**2.67**	4.91

Gross G&A expenses totaled $1,437,000 for the three-month period ended September 30, 2012 compared to $1,006,000 recorded in the comparable period of 2011 and $1,429,000 in the second quarter of 2012. Net G&A costs were $781,000 or $1.81/boe in the third quarter of 2012 compared to $756,000 or $3.85/boe a year ago and $984,000 or $2.84/boe recorded in the second quarter of 2012. When compared to the same quarter of the prior year, gross G&A costs have increased on an absolute basis due to increased staffing costs (including salaries, bonuses and office rent) associated with higher activity levels. Throughout the third quarter of 2012, the Company had an average of nineteen full-time employees and six consultants versus thirteen full-time employees and two consultants in the same period of 2011.

The Company capitalized direct G&A expenses amounting to $254,000 and had overhead recoveries of $402,000 in the third quarter of 2012 versus $189,000 and $28,000, respectively, in the comparative period of 2011, and $288,000 and $157,000, respectively, in the second quarter of 2012.

G&A net expenses for the first nine months of 2012 totaled $2,819,000 or $2.67/boe compared to $2,246,000 or $4.91/boe in the same period of 2011. During the nine months ended September 30, 2012, the Company capitalized $1,007,000 in direct costs relating to its exploration and development efforts and $682,000 of overhead recoveries compared to $494,000 and $112,000, respectively, in the same period of 2011.

Share-Based Compensation

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Gross share-based compensation	**762**	473	**2,343**	1,102
Share-based compensation reclassified to operating costs	**(27)**	(19)	**(85)**	(29)
Capitalized share-based compensation	**(267)**	(164)	**(851)**	(360)
Share-based compensation expense (net)	**468**	290	**1,407**	713
Share-based compensation expense (net) *($/boe)*	**1.08**	1.48	**1.33**	1.56

The Company has a stock option plan, which is described in note 10 of the unaudited interim financial statements. Options granted under the plan have a four-year vesting term, expire five years from the grant date and the fair value of all options granted is estimated at the grant date using the Black-Scholes option pricing model. Share-based compensation expense is a non-cash expense that reflects the amortization over the vesting period of the fair value of stock options granted to the employees, consultants and directors of the Company. For those stock options granted to field employees, their portion of the share-based compensation is reclassified to operating expenses to be consistent with the recognition of their salaries on the statement of operations and comprehensive loss.

For the quarter ended September 30, 2012, the Company incurred a net expense of $468,000 or $1.08/boe versus $290,000 or $1.48/boe in the same period of 2011 and $522,000 or $1.51/boe in the second quarter of 2012. This year-over-year increase was directly attributable to increased staffing.

During the first nine months of 2012, DeeThree incurred a net expense of $1,407,000 or $1.33/boe compared to $713,000 or $1.56/boe recorded a year ago.

Depletion and Depreciation ("D&D")

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
D&D provision	**8,628**	4,472	**21,478**	9,587
D&D provision *($/boe)*	**19.99**	22.77	**20.36**	20.94

D&D is computed on a unit-of-production basis. Such expense, on a boe basis, fluctuates period to period primarily as a result of changes in the underlying proved plus probable reserves base and in the amount of costs subject to D&D, including future development costs. Such costs are segregated and depleted on an area-by-area basis relative to the respective underlying proved plus probable reserves base.

Depreciation is provided on certain field facilities using the straight-line method over a 20-year useful life and on office assets using the declining balance method at rates between 20% and 30%.

The Company's D&D expense for the three months ended September 30, 2012 was $8,628,000 or $19.99/boe compared to $4,472,000 or $22.77/boe in the comparable period of 2011 and $6,898,000 or $19.92/boe in the second quarter of 2012. The year-over-year absolute increase was attributable to the increased value of the proved plus probable reserves added during 2011 and the first nine months of 2012 from the Company's drilling program, increased production related to those assets and related future development costs. However, the year-over-year per unit amounts have decreased due to the fact that successful 2012 wells have been added to the asset base at a lower cost per boe than the assets purchased in the March 2011 acquisition, which contributes to a lower D&D rate overall.

For the nine months ended September 30, 2012, D&D expense totaled $21,478,000 or $20.36/boe compared to $9,587,000 or $20.94/boe recorded in the same period of 2011.

Exploration and Evaluation ("E&E") Expense

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
E&E expense	**225**	665	**2,745**	665
E&E expense *($/boe)*	**0.52**	3.38	**2.60**	1.45

Under IFRS, DeeThree accumulates those costs related to E&E assets in one cost pool, pending determination of technical feasibility and commercial viability of the asset. This primarily includes costs for seismic data, undeveloped land and drilling costs until the drilling of the well is complete and results have been evaluated. Costs related to wells that have been determined to be uneconomical as well as cost of undeveloped land lease expiries are expensed as they occur.

During the third quarter of 2012, the Company recorded E&E expense of $225,000 or $0.52/boe, which related to lease expiries in several of the Company's areas versus $665,000 or $3.38/boe in the same period of 2011 and $1,388,000 or $4.01/boe in the second quarter of 2012. During the nine months ended September 30, 2012, the Company recorded E&E expense of $2,745,000 or $2.60/boe versus $665,000 or $1.45/boe in the comparable period of 2011.

Finance Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Finance income	–	50	–	204
Finance income *($/boe)*	–	0.25	–	0.45

In the third quarter of 2012, the Company recorded $nil finance income, compared to $50,000 or $0.25/boe during the same quarter of 2011 which was a result of the Company's positive cash balance during that period.

For the nine-month period ended September 30, 2012, the Company's finance income was $nil compared to $204,000 or $0.45/boe in the comparable period of 2011.

Accretion and Finance Expenses

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Accretion expense on decommissioning liabilities	**82**	69	**274**	159
Finance expense	**560**	22	**1,086**	114
Total accretion and finance expenses	**642**	91	**1,360**	273
Accretion expense on decommissioning liabilities *($/boe)*	**0.19**	0.35	**0.26**	0.35
Finance expense *($/boe)*	**1.30**	0.11	**1.03**	0.25
Total accretion and finance expenses *($/boe)*	**1.49**	0.46	**1.29**	0.60

Accretion expense represents the increase in the present value of the Company's decommissioning liabilities. In the third quarter of 2012, the Company recorded accretion expense of $82,000 or $0.19/boe compared to $69,000 or $0.35/boe in the same period of 2011 and $97,000 or $0.28/boe in the second quarter of 2012. The absolute increase is primarily due to the decommissioning liabilities added for the 2011 and 2012 drills. However, the expense per boe has decreased as a function of several things; first, as accretion is not a unit-based calculation, increased production volumes have spread the expense over a larger number of barrels and second, during Q3 2012, the Company revised the discount rate used to calculate the liability from 3.5% to 2.5% based on estimated interest rates in the market. This resulted in a revision to the decommissioning liability of $1,168,000 during the quarter and will result in lower accretion charges each period going forward. The underlying liability may increase over time based on new obligations incurred from drilling wells, constructing facilities, acquiring operations, adjusting future estimates of timing or estimated decommissioning costs. The liability can also be reduced as a result of abandonment work actually completed.

During the three months ended September 30, 2012, the Company recorded finance expenses of $560,000 or $1.30/boe compared to $22,000 or $0.11/boe in the same period of 2011 and $311,000 or $0.90/boe in the second quarter of 2012. The Company incurred interest charges and standby fees related to the $60,000,000 credit facility (2011 – $20,000,000), which was drawn to $48,877,000 at the end of the third quarter. The Company also incurred a commitment fee of $50,000 with regards to the new credit facility (see Subsequent Events for further details).

For the 2012 nine-month period, the Company recorded accretion expense of $274,000 or $0.26/boe versus $159,000 or $0.35/boe and finance expenses of $1,086,000 or $1.03/boe versus $114,000 or $0.25/boe in the comparable period last year.

Income Taxes

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Deferred income tax expense	**1,001**	554	**2,868**	1,842
Deferred income tax expense *($/boe)*	**2.32**	2.82	**2.72**	4.02

During the third quarter of 2012, the Company recorded a deferred income tax expense of $1,001,000 or $2.32/boe compared to an expense of $554,000 or $2.82/boe in same period of 2011 and expense of $2,379,000 or $6.87/boe in the second quarter of 2012. The current quarter expense was primarily related to an increase in the taxable base of the oil and gas assets offset by a change to the non-capital loss provision from the prior year. The movement in the taxable base of oil and gas assets is due to the Company's capital spending associated with flow-through shares. As costs are incurred, the Company reverses the flow-through share liability and recognizes the deferred income tax expense at that time. During the three months ended September 30, 2012, the Company spent approximately $2,395,000 in eligible capital expenditures related to the March 2012 issuance of flow-through shares.

DeeThree does not have current income taxes payable and does not expect to pay current income taxes in 2012 as the Company had estimated tax pools available at September 30, 2012 of $250,000,000.

Funds from Operations

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Net income (loss)	**1,294**	(353)	**3,698**	(3,243)
Non-cash items:				
D&D	**8,628**	4,472	**21,478**	9,587
Deferred income tax expense	**1,001**	554	**2,868**	1,842
Share-based compensation (1)	**495**	309	**1,492**	742
Accretion	**82**	69	**274**	159
Unrealized loss (gain) on financial instruments	**2,540**	(1,921)	**(2,697)**	(2,013)
E&E expense	**225**	665	**2,745**	665
Funds from operations	**14,265**	3,795	**29,858**	7,739

(1) The share-based compensation amount included in the calculation of funds from operations has been adjusted for the non-cash portion related to certain field employees that was reclassified to operating expenses for presentation in the statement of operations and comprehensive income (loss).

During the three months ended September 30, 2012, the Company generated funds from operations totaling $14,265,000 or $0.21 per basic share and $0.20 per diluted share compared to $3,795,000 or $0.06 per basic and diluted share in the comparative period of 2011 and $9,852,000 or $0.15 per basic share and $0.14 per diluted share in the second quarter of 2012. This 276% year-over-year increase was primarily due to increased revenue from production offset by increased royalties and operating and transportation costs.

Funds from operations totaled $29,858,000 or $0.45 per basic share and $0.42 per diluted share for the nine months ended September 30, 2012 compared to $7,739,000 or $0.14 per basic and diluted share recorded in the same period of 2011.

Net Income (Loss)

For the three months ended September 30, 2012, the Company recorded a net income of $1,294,000 or $0.02 per basic and diluted share compared to a net loss of $353,000 or $0.01 per basic and diluted share in the same period of 2011 and net income of $5,603,000 or $0.08 per basic and diluted share in the second quarter of 2012. The Company's positive net income for the quarter was primarily due to increased production, leading to increased revenues in the period, compounded by decreasing royalties and operating expenses on a per barrel basis.

The net income for the nine months ended September 30, 2012 was $3,698,000 or $0.06 per basic share and $0.05 per diluted share versus a net loss of $3,243,000 or $0.06 per basic and diluted share in the comparative period of 2011.

Netbacks (per unit) [3]

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
	($/boe)	*($/boe)*	*($/boe)*	*($/boe)*
Sales prices	**55.65**	48.05	**53.79**	45.59
Royalties	**(8.77)**	(9.40)	**(9.42)**	(7.87)
Operating	**(9.83)**	(15.26)	**(11.68)**	(12.61)
Transportation	**(1.87)**	(1.03)	**(1.71)**	(1.35)
Operating netback [1]	**35.18**	22.36	**30.98**	23.76
G&A and other (excludes non-cash items) [2]	**(1.81)**	(4.02)	**(2.67)**	(7.43)
Realized gain on financial instruments	**0.91**	0.73	**0.95**	0.31
Finance income	**–**	0.25	**–**	0.45
Finance expenses	**(1.30)**	(0.11)	**(1.03)**	(0.25)
Funds flow netback [1]	**32.98**	19.21	**28.23**	16.84
D&D	**(19.99)**	(22.77)	**(20.36)**	(20.94)
Accretion	**(0.19)**	(0.35)	**(0.26)**	(0.35)
Share-based compensation	**(1.08)**	(1.48)	**(1.33)**	(1.56)
Unrealized gain (loss) on financial instruments	**(5.88)**	9.78	**2.56**	4.40
E&E expense	**(0.52)**	(3.38)	**(2.60)**	(1.45)
Deferred income tax expense (recovery)	**(2.32)**	(2.82)	**(2.72)**	(4.02)
Net income (loss) netback [1]	**3.00**	(1.81)	**3.52**	(7.08)

(1) Non-IFRS measure: refer to the commentary at the beginning of this MD&A. Operating netback, funds flow netback and net income (loss) netback are calculated by dividing operating income, funds flow from operations and the net income (loss) by the sales volume in boes for the period then ended. For a description of the boe conversion ratio, refer to the "Other Measurements" commentary at the beginning of this MD&A.

(2) For the nine month period ended September 30, 2011, G&A and other includes transaction costs of $1,158,000 relating to the acquisition of the Peace River Arch and Brazeau properties.

(3) For a description of the boe conversion ratio, refer to the commentary at the beginning of this MD&A.

The operating netback was $35.18/boe for the three months ended September 30, 2012 compared to $22.36/boe in the same period last year and $30.86/boe in the second quarter of 2012. As compared to the prior year, the Company experienced a higher realized average price throughout the three months ended September 30, 2012. Even though each individual product had a lower realized price in the period as compared to the same period of 2011, the higher realized average price and resulting higher netback was largely the result of a shift to a proportionately higher oil production base, which attracts higher pricing. The improved netback was also positively impacted by decreased royalties and operating costs during the quarter.

For the first nine months of 2012, DeeThree achieved an operating netback of $30.98/boe versus $23.76/boe in the same period of 2011, again related to higher pricing.

Investment and Investment Efficiencies

Capital Expenditures and Acquisitions

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)(excluding decommissioning liabilities and capitalized share-based compensation)	*($)*	*($)*	*($)*	*($)*
Property acquisitions and adjustments	**–**	1,966	**–**	126,411
Drilling and completions	**25,891**	19,753	**77,666**	35,319
Equipment and facilities	**6,089**	1,803	**12,151**	2,038
Land and lease retention	**999**	1,177	**8,597**	2,639
Geological and geophysical	**(37)**	70	**169**	33
Capitalized G&A and other	**263**	240	**1,036**	588
Total capital expenditures	**33,205**	25,009	**99,619**	167,028
Proceeds from farm-outs	**–**	–	**(1,000)**	(5,000)
Total capital expenditures, net proceeds from farm-outs	**33,205**	25,009	**98,619**	162,028

During the third quarter of 2012, the Company incurred a total of $33,205,000 (2011 – $25,009,000) in capital expenditures, excluding the non-cash decommissioning liabilities and capitalized share-based compensation. With the Company's current shift in focus to deep horizontal Bakken locations, drilling and completion expenditures totaled $25,891,000 (2011 – $19,753,000), including the drilling of 5 gross (5.0 net) wells. In addition to the 5.0 gross (5.0 net) wells drilled in the quarter, 3.0 gross (3.0 net) wells were in progress over the quarter end, whereby approximately $4,200,000 of drilling expenditures were included in the third quarter. In the comparative quarter of 2011, the Company drilled 9 gross (7.6 net) wells and incurred significant completion expenditures. For the three months ended September 30, 2012, DeeThree spent $6,089,000 (2011 – $1,803,000) on tie-ins and facilities, which in 2012 consisted primarily of expenditures related to tie-in of the 2012 drills as well as construction of an amine plant and battery in the Lethbridge area. The Company spent $999,000 (2011 – $1,177,000) on Crown land sales and received $37,000 in credits (2011 – expenses of $70,000) related to seismic programs. The remaining $263,000 (2011 – $240,000) was invested in capitalized G&A and other corporate assets.

For the first nine months of 2012, capital expenditures totaled $99,619,000 versus $167,028,000 in the comparative period of 2011. A significant portion of the 2011 capital spending was directed towards the acquisition of the Peace River and Brazeau properties for a consideration of $126,411,000 after certain adjustments. As the Company's focus has shifted to drilling mainly in the Brazeau and Lethbridge properties this year, no capital was spent on acquisitions so far during 2012. Drilling and completion expenditures totaled $77,666,000 (2011 – $35,319,000), equipment and facility costs were $12,151,000 (2011 – $2,038,000), $8,597,000 (2011 – $2,639,000) was spent on land purchases, $169,000 was spent related to the purchase of seismic programs (2011 – $33,000) and the remaining $1,036,000 (2011 – $588,000) was invested in capitalized G&A and other corporate assets. In the first nine months of 2012, the Company also received $1,000,000 as proceeds from a default on a farm-out agreement entered into during the second quarter of 2011 (2011 – $5,000,000 as initial payment for the farm-out), which was recorded against E&E and partially offset the total capital expenditures for the period.

Drilling Activity

	Exploration		Development		Total	
	Gross	Net	Gross	Net	Gross	Net
	(#)	*(#)*	*(#)*	*(#)*	*(#)*	*(#)*
Three Months Ended September 30, 2012						
Natural gas	**–**	**–**	**–**	**–**	**–**	**–**
Crude oil and NGLs	**–**	**–**	**5**	**5.0**	**5**	**5.0**
Standing	**–**	**–**	**–**	**–**	**–**	**–**
Dry and abandoned	–	–	–	–	–	–
Total wells	**–**	**–**	**5**	**5.0**	**5**	**5.0**
Success rate *(%)*		**–**		**100**		**100**
Average working interest *(%)*		**–**		**100**		**100**
Three Months Ended September 30, 2011						
Natural gas	–	–	–	–	–	–
Crude oil and NGLs	–	–	3	2.8	3	2.8
Standing	3	1.8	2	2.0	5	3.8
Dry and abandoned	1	1.0	–	–	1	1.0
Total wells	4	2.8	5	4.8	9	7.6
Success rate *(%)*		75		100		89
Average working interest *(%)*		70		96		84
Nine Months Ended September 30, 2012						
Natural gas	**–**	**–**	**–**	**–**	**–**	**–**
Crude oil and NGLs	**2**	**2.0**	**18**	**16.9**	**20**	**18.9**
Standing	**–**	**–**	**2**	**2.0**	**2**	**2.0**
Dry and abandoned	**–**	**–**	**–**	**–**	**–**	**–**
Total wells	**2**	**2.0**	**20**	**18.9**	**22**	**20.9**
Success rate *(%)*		**100**		**100**		**100**
Average working interest *(%)*		**100**		**94**		**95**
Nine Months Ended September 30, 2011						
Natural gas	–	–	–	–	–	–
Crude oil and NGLs	4	4.0	3	2.8	7	6.8
Standing	3	1.8	2	2.0	5	3.8
Dry and abandoned	1	1.0	–	–	1	1.0
Total wells	8	6.8	5	4.8	13	11.6
Success rate *(%)*		88		100		92
Average working interest *(%)*		85		96		89

During the third quarter of 2012, DeeThree drilled 5 gross (5.0 net) Bakken wells on its Lethbridge property with a 100% success rate. During the three months ended September 30, 2011, the Company drilled 9 gross (7.6 net) wells for an 89% success rate, including 2 gross (1.8 net) horizontal Belly River wells in the Brazeau area, 3 gross (3.0 net) Sunburst wells in the Lethbridge area, 2 gross (0.8 net) non-operated Bakken wells and 2 horizontal Montney wells in the Rycroft area.

During the first nine months of 2012, DeeThree drilled 15 gross (15.0 net) wells at Lethbridge, 6 gross (5.6 net) wells at Brazeau and 1 gross (0.29 net) wells at Rycroft for a 100% success rate on 22 gross (20.9 net) wells year to date compared to 13 gross (11.6 net) wells in the Brazeau, Lethbridge and Rycroft areas for a 92% success rate a year ago.

Liquidity and Capital Resources

Working Capital

The following table summarizes the change in working capital during the nine months ended September 30, 2012 and the year ended December 31, 2011:

	Nine Months Ended September 30, 2012	Year Ended December 31, 2011
(000s)	*($)*	*($)*
Working capital (deficit) – beginning of period	**(16,901)**	28,505
Abandonment and reclamation costs	**(108)**	(116)
Funds from operations	**29,858**	11,833
Issue of capital stock for cash (net of share issue expenses)	**16,072**	122,434
Capital expenditures	**(99,619)**	(61,578)
Acquisitions	**–**	(125,979)
Proceeds from farm-outs	**1,000**	8,000
Working capital deficit – end of period	**(69,698)**	(16,901)

DeeThree entered 2012 with a working capital deficit of $16,901,000. In March 2012, the Company issued 3,834,100 flow-through shares at a price of $4.50 per flow-through share for total gross proceeds of $17,253,450 ($16,012,450 net of estimated share issue expenses). The proceeds of the flow-through share offering will be used by the Company to conduct exploration activity on its properties. In September 2012, the Company also issued common shares on the exercise of options for total cash proceeds of $60,000. During the period, the Company generated funds from operations of $29,858,000 and invested a total of $99,619,000 in capital. The Company also received $1,000,000 as proceeds from a farm-out agreement entered into during the second quarter of the prior year, which was recorded against E&E and partially offset the total capital expenditures for the period. DeeThree exited the period with a working capital deficit of $69,698,000.

At September 30, 2012, the Company had a revolving demand credit facility to $60,000,000 with interest charged at the bank's prime rate plus a range of 1.0% to 1.25% per annum based on the Company's consolidated debt to cash flow ratio. Standby fees associated with this facility range from 0.40% to 0.70% per annum on the undrawn portion of the facility, again based on the Company's consolidated debt to cash flow ratio. As at September 30, 2012, $48,877,000 was drawn against the facility. Collateral for this facility consists of a general security agreement, providing a security interest over all present and after acquired personal property, and a floating charge on all present and after acquired land interests of the Company.

Subsequent to the quarter end, the Company funded a new credit facility for $90,000,000. Please see Subsequent Events for further details. The facility is a subject to semi-annual reviews by the Company's lender with the next review scheduled for the spring of 2013.

Also subsequent to the quarter end, the Company issued 3,139,500 common shares at a price of $5.50 per common share, including 409,500 common shares ($2,252,250) issued on the exercise in full of the underwriters' over-allotment option and 770,000 flow-through shares at a price of $6.50 per flow-through share for total gross proceeds of $22,272,250 ($20,800,000 net of estimated share issue expenses). The proceeds of the share offering will be used to conduct development and exploration activity on the Company's Belly River formations on its lands in its Brazeau area as well as additional Alberta Bakken targets on the Lethbridge Property.

DeeThree expects to fund future capital expenditures with its funds flow from operations and the unused demand credit facility.

Related Party Transactions and Off-Balance Sheet Transactions

As at September 30, 2012, the Company had the following related party transactions:

The Company has retained a law firm to provide legal services. The Corporate Secretary of DeeThree is a partner of this firm. During the nine months ended September 30, 2012, the Company incurred $377,000 in costs with the firm (2011 – $448,000), which have been included in G&A expenses and share issue costs, and $87,000 (2011 – $nil) remained in accounts payable at September 30, 2012. Services provided related to advice and counsel primarily in the areas of general legal, corporate governance and banking matters. The Company expects to continue using the services of this firm throughout the balance of 2012.

All related party transactions were in the normal course of operations and have been measured at exchange amounts established and agreed to by the related parties and which are similar to those that the Company would expect to have negotiated with third parties in similar circumstances.

There were no off-balance sheet transactions entered into during the period nor were there any outstanding as at the date of this MD&A.

Contractual Obligations and Commitments

Years Ended December 31,	2012	2013	2014	2015+	Total
(000s)	*($)*	*($)*	*($)*	*($)*	*($)*
Operating lease – office	160	640	640	800	2,240
Operating lease – equipment	67	76	17	–	160
Exploration expenditures (flow-through)	–	19,214	–	–	19,214
Drilling contracts	1,625	5,121	–	–	6,746
Bank debt	48,877	–	–	–	48,877
Total	50,729	25,051	657	800	77,237

As at September 30, 2012, the Company had contractual obligations for its office lease totaling approximately $2,240,000 to March 2016. The head office lease obligations are comprised of the lease and includes parking and an estimate of occupancy costs of the Company's head office space. The Company also had contractual obligations for several vehicles totaling approximately $160,000 to the end of 2014.

In connection with the issuance of flow-through shares by the Company during the first quarter of 2012, DeeThree is required to spend $17,253,450 of eligible exploration expenditures by December 31, 2013. As at September 30, 2012, $3,044,450 of these eligible exploration expenditures had been incurred. The remaining $14,209,000 will be incurred during the rest of 2012 and 2013. These expenditures will be renounced to shareholders in January 2013 effective December 31, 2012.

Subsequent to the quarter end, the Company issued an additional 770,000 flow-through shares and will be required to spend an additional $5,005,000 of eligible exploration expenditures by December 31, 2013. These expenditures will be incurred during 2013 and will be renounced to shareholders in January 2013 effective December 31, 2012.

During 2011, DeeThree entered into contracts for drilling rig services, and as at September 30, 2012, the Company had committed to using services totaling $6,746,000 extending into 2013.

At September 30, 2012, the Company also had the obligation to repay the amount outstanding on the revolving demand credit facility, which was drawn to $48,877,000 at period-end.

Share Capital

As at November 13, 2012, the Company had 71,035,173 common shares outstanding and 5,744,632 stock options outstanding.

Selected Quarterly Information [1]

Three Months Ended	**Sept. 30 2012**	Jun. 30, 2012	Mar. 31, 2012	Dec. 31, 2011	Sep. 30, 2011	Jun. 30, 2011	Mar. 31, 2011	Dec. 31, 2010
(000s, except per share amounts)	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*
Oil and natural gas revenues	**24,020**	18,437	14,277	11,873	9,440	9,465	1,969	1,483
Funds from (used in) operations	**14,265**	9,852	5,741	4,094	3,795	4,777	(833)	8
Per share – basic	**0.21**	0.15	0.09	0.06	0.06	0.08	(0.02)	–
Per share – diluted	**0.20**	0.14	0.09	0.06	0.06	0.08	(0.02)	–
Cash flow from (used in) operating activities	**12,555**	14,696	4,064	754	8,910	2,299	(4,863)	(23)
Net income (loss)	**1,294**	5,603	(3,199)	(9,330)	(353)	(899)	(1,991)	(5,738)
Per share – basic and diluted	**0.02**	0.08	(0.05)	(0.15)	(0.01)	(0.01)	(0.05)	(0.23)
Total assets	**292,348**	266,649	240,124	213,239	206,885	195,267	192,682	65,334
Capital expenditures [2]	**33,205**	29,699	36,715	20,529	25,009	12,490	129,529	7,532
Working capital (deficit) [3]	**(69,698)**	(50,803)	(30,898)	(16,901)	(3,356)	17,871	20,659	28,505
Shareholders' equity	**187,308**	185,207	178,732	167,568	176,346	174,850	175,423	55,126
Production								
Natural gas *(mcf/d)*	**8,883**	8,687	8,657	7,714	8,167	8,214	3,744	3,691
Crude oil *(bbls/d)*	**2,953**	2,091	1,316	957	597	609	71	18
NGLs *(bbls/d)*	**259**	266	283	161	177	189	18	1
Total *(boe/d)*	**4,692**	3,805	3,042	2,403	2,135	2,167	713	635

(1) The selected quarterly information has been prepared in accordance with the accounting principles as contained in the notes to the unaudited interim financial statements, except for funds from (used in) operations, which is a non-prescribed measure under IFRS.

(2) Total capital expenditures, including acquisitions.

(3) Current assets less current liabilities, excluding current derivative financial instruments.

Factors That Have Caused Variations over the Quarters

During the first quarter of 2011, DeeThree completed the acquisition of the Peace River and Brazeau properties that significantly increased the Company's revenues, funds from operations and cash flow in subsequent periods. DeeThree's production also increased significantly and shifted from an approximate 98% natural gas focus to approximately 63% natural gas and 37% crude oil and NGLs for the year ended December 31, 2011.

During 2012, the Company has been successful with an active drilling program primarily in the Lethbridge Bakken and Brazeau properties. Capital expenditures of $99,619,000 in the first nine months have resulted in 22 gross (20.9 net) wells drilled. This has contributed to a 120% year-over-year volume increase and a production split of 38% natural gas and 62% oil and NGLs for the nine month period.

For the quarter ended September 30, 2012, the Company achieved an improved operating netback of $35.18/boe, which is attributable to several factors. First, with a revised production split of 69% oil and NGLs and average production of 4,692 boe per day, the average realized price was $55.65/boe. The Company has also seen a decrease in operating costs per barrel, both as a function of economies of scale from increased production and from positive improvements to operations (including expanding the battery and infrastructure owned and used in Lethbridge). The higher netbacks ultimately resulted in positive funds from operations of $14,265,000 for the period.

Please refer to the "Financial and Operating Results" section and other sections of this MD&A for detailed discussions on variations during the comparative quarters and to DeeThree's previously issued interim and annual MD&A for changes in prior quarters.

Critical Estimates

The preparation of the Company's financial statements requires management to adopt accounting policies that involve the use of significant estimates and assumptions. These estimates and assumptions are developed based on the best available information and are believed by management to be reasonable under the existing circumstances. New events or additional information may result in the revision of these estimates over time. The following discussion outlines some of the accounting policies and practices that are critical to determining DeeThree's financial results and a summary of the critical estimates and judgements used by DeeThree can be found in note 2 to the December 31, 2011 audited annual financial statements.

Reserves Determination

The proved natural gas, crude oil and NGLs reserves that are used in determining DeeThree's depletion rates, the magnitude of the borrowing base available to the Company from its lender and the ceiling test are based on management's best estimates, and are subject to uncertainty. Through the use of geological, geophysical and engineering data, the reservoirs and deposits of natural gas, crude oil and NGLs are examined to determine quantities available for future production, given existing operations and economic conditions and technology. The evaluation of recoverable reserves is an ongoing process impacted by current production, continuing development activities and changing economic conditions as reflected in natural gas and crude oil prices. Consequently, the reserves are estimated, which are subject to variability. To assist with the reserves evaluation process, the Company employs the services of independent oil and gas reservoir engineers.

Income Taxes

The determination of DeeThree's income and other tax liability requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from the liability estimated or recorded.

Other Estimates

The accrual method of accounting will require management to incorporate certain estimates, including revenues, royalties, production costs and capital expenditures as at a specific reporting date but for which actual revenue and royalties have not yet been received, and estimates on capital projects that are in progress or recently completed where actual costs have not been received at a specific reporting date.

Controls and Procedures

Disclosure Controls

Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company is accumulated and communicated to management (including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO")) to allow timely decisions regarding required disclosure.

DeeThree's CEO and CFO have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes. Based on their evaluation, DeeThree's CEO and CFO have concluded that, as of December 31, 2011, the Company's internal controls and procedures over financial reporting were effective. DeeThree is required to disclose herein any change in the design of the Company's internal control over financial reporting that occurred during the period ended September 30, 2012 that has materially affected, or is reasonably likely to materially affect, DeeThree's internal control over financial reporting. DeeThree confirms that no such changes were made to its internal controls over financial reporting during the period.

Internal Controls over Financial Reporting

DeeThree is required to comply with Multilateral Instrument 52-109 – "Certification of Disclosure in Issuers' Annual and Interim Filings". The certificate of interim filings for the period ended September 30, 2012 requires that DeeThree disclose in the interim MD&A any changes in the Company's internal control over financial reporting that occurred during the period that has materially affected, or is reasonably likely to materially affect DeeThree's internal control over financial reporting. DeeThree confirms that no such changes were made to internal controls over financial reporting during the period.

It should be noted that while DeeThree's CEO and CFO believe that the Company's internal controls and procedures provide a reasonable level of assurance and are effective, they do not expect that these controls will prevent all errors or fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Accounting Standards Issued But Not Yet Applied

IFRS 9 – "Financial Instruments" was issued by the IASB in November 2009 and was the first step to replace IAS 39 – "Financial Instruments: Recognition and Measurement". In October 2010, the requirements for classifying and measuring financial liabilities were added to IFRS 9. Under this guidance, entities would be required to reverse the portion of the fair value change due to a company's own credit risk out of earnings and recognize the change in other comprehensive income. IFRS 9 is effective for the Company on January 1, 2015. DeeThree is currently evaluating the impact of IFRS 9 on its financial statements and believes there will be no significant impact to the Company upon implementation of the standard.

IAS 12 – "Income Taxes" was amended on December 20, 2010 to remove subjectivity in determining on which basis an entity measures the deferred tax relating to an asset. The amendment introduces a presumption that an entity will assess whether the carrying value of an asset will be recovered through the sale of the asset. The amendment to IAS 12 is effective for reporting periods beginning on or after January 1, 2012. The Company is currently evaluating the impact of this amendment to IAS 12 on its financial statements.

IFRS 10 – "Consolidated Financial Statements" replaces IAS 27 – "Consolidated Separate Financial Statements". IFRS 10 introduces a single control model to assess whether to consolidate an investee. The standard was issued as part of a new suite of consolidation and related standards replacing existing requirements for joint ventures (now joint arrangements) and making limited amendments in relation to associates. The new requirements are effective in annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of IFRS 10 and believes the standard will not be applicable to the preparation of its financial statements.

IFRS 11 and IAS 28 – "Joint Arrangements and Investments in Subsidiaries" were issued as part of its new suite of consolidation and related standards, replacing existing requirements for subsidiaries. Under IFRS 11 and IAS 28, classification of the joint arrangement depends on whether parties have rights to, and obligations for, underlying assets and liabilities; joint ventures are no longer allowed to use proportionate consolidation and must use equity accounting. The new requirements are effective in annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of IFRS 9 and IAS 28 and believes the standard will not be applicable to the preparation of its financial statements.

IFRS 12 – "Disclosure of Interests in Other Entities" is a new standard, which combines all of the disclosure requirements for subsidiaries, associates and joint arrangements, as well as unconsolidated structured entities. The new requirements are effective in annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of IFRS 12 and believes the standard will not be applicable to the preparation of its financial statements.

IFRS 13 – "Fair Value Measurement" is a new standard meant to clarify the definition of fair value, provide guidance on measuring fair value and improve disclosure requirements related to fair value measurement. DeeThree is currently evaluating the impact of IFRS 13 on its financial statements and believes there will be no significant impact to the Company upon implementation of the standard.

In June 2011, the IASB published amendments to IAS 1 – "Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income", which are effective for annual periods beginning on or after July 1, 2012 and are to be applied retrospectively. Early adoption is permitted. The amendments require that an entity present separately the items of other comprehensive income that may be reclassified to profit or loss in the future from those that would never be reclassified to profit or loss. The Company intends to adopt the amendments in its financial statements for the annual period beginning on January 1, 2013. As the amendments only require changes in the presentation of items in other comprehensive income, the Company does not expect the amendments to IAS 1 to have a material impact on the financial statements.

Business Risks and Risk Mitigation

DeeThree's exploration and production activities are concentrated in the Western Canadian Sedimentary Basin where the industry is very competitive. There are a number of risks facing participants in the oil and gas industry, some of which are common to all businesses, while others are specific to the sector. Such risks include finding and developing oil and natural gas reserves economically, estimating amounts of recoverable reserves, producing the reserves in commercial quantities, finding a suitable market at attractive commodity prices, financial and liquidity risks, and environmental and safety risks.

DeeThree mitigates these risks by utilizing a team of highly qualified professionals with expertise and experience in these areas. DeeThree attempts to maximize drilling success by exploring areas that have multi-zone horizons, targeting deeper horizons with uphole potential, continuously assessing new acquisition opportunities to complement existing activities and balancing higher risk exploratory drilling with lower risk development drilling.

Beyond exploration risk, there is the potential that the Company's natural gas and crude oil reserves may not be economically produced at prevailing prices. DeeThree minimizes this risk by generating exploration prospects internally, targeting high quality projects, attempting to operate the project by accessing sales markets through Company owned infrastructure or mid-stream operators.

DeeThree has retained an independent engineering consulting firm that assists the Company in evaluating recoverable amounts of oil and natural gas reserves. Values of recoverable reserves are based on a number of variable factors and assumptions such as commodity prices, projected production, future production costs and governmental regulation. Consequently, estimates could vary from actual results.

DeeThree is exposed to commodity price risk whereby the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by not only the relationship between the Canadian and United States dollars, but also global economic events that dictate the levels of supply and demand. The Company seeks to protect itself from fluctuations in prices by maintaining an appropriate hedging strategy. As at the date of this MD&A, DeeThree has nine crude oil hedges in place (see "Commodity Prices and Foreign Exchange" section). Most commodity prices are based on U.S. dollar benchmarks, which result in the Company's realized prices being influenced by the Canadian/U.S. exchange rates. The Company does not sell or transact in foreign currency, but may be impacted by foreign currency exchange rate changes related to commodity prices as outlined above. At the date of this MD&A, DeeThree had three foreign currency exchange risk management contracts in place.

Credit risks arise from a counterparty failing to meet its obligations in accordance with the agreed upon terms. The Company may be exposed to third party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of its commodities and other parties. DeeThree makes every effort to sell its commodities to major companies with excellent credit ratings.

The oil and natural gas industry is a very capital intensive industry, and in order to fully realize the Company's strategic goals and business plans, DeeThree will rely on equity markets as a source of new capital in addition to bank financing and internally generated cash flow to fund its ongoing capital investments. DeeThree's ability to raise additional capital will depend on a number of factors such as general economic and market conditions that are beyond the Company's control. Internally generated funds will also fluctuate with changing commodity prices. DeeThree anticipates it will continue to have adequate liquidity to fund its financial liabilities through its future funds from operations and available bank credit. DeeThree is committed to maintaining a strong balance sheet along with an adaptable capital expenditures program that can be adjusted to capitalize on, or reflect, acquisition opportunities and, if necessary, a tightening of liquidity sources. DeeThree has had no defaults or breaches on its bank debt or any of its financial liabilities.

There are numerous environmental risks associated with oil and natural gas exploration and production. Some of these risks can involve pollution of the environment and destruction of natural habitat as well as safety risks such as personal injury. DeeThree has established an Environmental, Health and Safety Program and has updated its operational emergency response plan and operational safety manual to address these operational issues. In addition, a comprehensive insurance program is maintained to mitigate risks and protect against significant losses where possible. DeeThree operates in accordance with all applicable environmental legislation and strives to maintain compliance with such regulations.

In addition, DeeThree is also subject to other risks and uncertainties which are described in the Company's Annual Information Form dated March 28, 2012.

Outlook

Subsequent to the quarter end, the Company successfully closed an equity issue raising net proceeds of approximately $21 million. With the completion of a significant increase to our credit facility and an equity financing in recent weeks, the Company is well positioned to deliver strong growth throughout the final quarter of 2012 and beyond. The Company intends to increase its 2012 capital budget by approximately $30 million to $140 million in total. By year end, the Company will have drilled 16.0 gross (16.0 net) Bakken wells, 8 gross (7.5 net) Belly River wells, 4.0 gross (4.0 net) Sunburst wells and one gross (0.3 net) non-operated well in the Rycroft area. The Company remains on target to reach its exit guidance of 6,000 boe/d by year end.

STATEMENTS OF FINANCIAL POSITION

As at	**September 30, 2012**	December 31, 2011
(000s)(unaudited)	*($)*	*($)*
Assets		
Current assets		
Accounts receivable	**17,494**	15,906
Deposits and prepaid expenses	**704**	500
Derivative financial instruments *(note 12)*	**1,398**	–
	19,596	16,406
Non-current assets		
Exploration and evaluation assets *(note 5)*	**30,642**	18,631
Property and equipment *(note 6)*	**241,840**	176,562
Deferred tax asset	**–**	1,640
Long-term derivative financial instruments *(note 12)*	**270**	–
Total assets	**292,348**	213,239
Liabilities		
Current liabilities		
Bank debt *(note 7)*	**48,877**	8,521
Accounts payable and accrued liabilities	**39,019**	24,786
Derivative financial instruments *(note 12)*	**–**	383
	87,896	33,690
Non-current liabilities		
Decommissioning liabilities *(note 8)*	**12,569**	10,363
Flow-through share premium liabilities *(note 9)*	**2,210**	973
Deferred tax liability	**2,365**	–
Long-term derivative financial instruments *(note 12)*	**–**	645
Total liabilities	**105,040**	45,671
Shareholders' equity		
Share capital *(note 9)*	**210,648**	196,901
Contributed surplus	**5,046**	2,751
Deficit	**(28,386)**	(32,084)
Total shareholders' equity	**187,308**	167,568
Total liabilities and shareholders' equity	**292,348**	213,239

Commitments *(note 13)*
Subsequent events *(notes 7 and 14)*

See accompanying notes to the financial statements.

STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s, except per share amounts)(unaudited)	*($)*	*($)*	*($)*	*($)*
Revenue				
Oil and natural gas revenues	**24,020**	9,440	**56,734**	20,874
Royalties	**(3,785)**	(1,847)	**(9,935)**	(3,604)
Oil and natural gas revenues, net of royalties	**20,235**	7,593	**46,799**	17,270
Expenses				
Operating and transportation	**5,049**	3,200	**14,120**	6,390
General and administrative	**781**	789	**2,819**	3,404
Depletion and depreciation *(note 6)*	**8,628**	4,472	**21,478**	9,587
Share-based compensation *(note 10)*	**468**	290	**1,407**	713
Exploration and evaluation expense *(note 5)*	**225**	665	**2,745**	665
	15,151	9,416	**42,569**	20,759
Unrealized loss (gain) on financial instruments	**2,540**	(1,921)	**(2,697)**	(2,013)
Realized gain on financial instruments	**(393)**	(144)	**(999)**	(144)
Accretion and finance expenses *(note 8)*	**642**	91	**1,360**	273
Finance income	**–**	(50)	**–**	(204)
	17,940	7,392	**40,233**	18,671
Income (loss) before income tax	**2,295**	201	**6,566**	(1,401)
Taxes				
Deferred income tax expense	**1,001**	554	**2,868**	1,842
Net income (loss) and comprehensive income (loss) for the period	**1,294**	(353)	**3,698**	(3,243)
Deficit, beginning of period	**(29,680)**	(22,401)	**(32,084)**	(19,511)
Deficit, end of period	**(28,386)**	(22,754)	**(28,386)**	(22,754)
Net income (loss) per share *(note 9)*				
Basic	**0.02**	(0.01)	**0.06**	(0.06)
Diluted	**0.02**	(0.01)	**0.05**	(0.06)

See accompanying notes to the financial statements.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Share Capital	Contributed Surplus	Deficit	Total Equity
(000s)(unaudited)	*($)*	*($)*	*($)*	*($)*
Balance – January 1, 2012	**196,901**	**2,751**	**(32,084)**	**167,568**
Flow-through shares issued	**17,253**	**–**	**–**	**17,253**
Share issue costs	**(1,241)**	**–**	**–**	**(1,241)**
Tax benefit of share issue costs	**311**	**–**	**–**	**311**
Premium on flow-through shares	**(2,684)**	**–**	**–**	**(2,684)**
Share-based compensation	**–**	**2,343**	**–**	**2,343**
Exercise of options	**108**	**(48)**	**–**	**60**
Net loss	**–**	**–**	**3,698**	**3,698**
Balance – September 30, 2012	**210,648**	**5,046**	**(28,386)**	**187,308**
Balance – January 1, 2011	73,530	1,107	(19,511)	55,126
Common shares issued	116,602	–	–	116,602
Flow-through shares issued	15,450	–	–	15,450
Share issue costs	(8,283)	–	–	(8,283)
Tax benefit of share issue costs	2,094	–	–	2,094
Premium on flow-through shares	(2,550)	–	–	(2,550)
Share-based compensation	–	1,102	–	1,102
Exercise of options	58	(10)	–	48
Net loss	–	–	(3,243)	(3,243)
Balance – September 30, 2011	196,901	2,199	(22,754)	176,346

See accompanying notes to the financial statements.

STATEMENTS OF CASH FLOWS

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)(unaudited)	*($)*	*($)*	*($)*	*($)*
Cash flow from (used in):				
Operating activities				
Net income (loss) for the period	**1,294**	(353)	**3,698**	(3,243)
Adjustments for:				
Depletion and depreciation	**8,628**	4,472	**21,478**	9,587
Deferred income tax expense	**1,001**	554	**2,868**	1,842
Share-based compensation	**495**	309	**1,492**	742
Accretion *(note 8)*	**82**	69	**274**	159
Unrealized loss (gain) on financial instruments	**2,540**	(1,921)	**(2,697)**	(2,013)
Exploration and evaluation expense	**225**	665	**2,745**	665
Change in non-cash working capital *(note 11)*	**(1,710)**	5,115	**1,457**	(1,393)
	12,555	8,910	**31,315**	6,346
Financing activities				
Increase in bank debt	**12,007**	–	**40,356**	–
Issuance of share capital	**60**	–	**17,313**	130,717
Share issue expenses	**(15)**	(7)	**(1,241)**	(8,283)
Changes in non-cash working capital *(note 11)*	**–**	–	**50**	–
	12,052	(7)	**56,478**	122,434
Investing activities				
Property and equipment expenditures	**(28,051)**	(27,059)	**(84,413)**	(25,811)
Exploration and evaluation expenditures	**(5,154)**	4,016	**(15,206)**	(14,806)
Proceeds from farm-outs *(note 5)*	**–**	–	**1,000**	5,000
Property acquisitions *(note 4)*	**–**	(1,966)	**–**	(126,411)
Changes in non-cash working capital *(note 11)*	**8,598**	1,587	**10,826**	7,711
	(24,607)	(23,422)	**(87,793)**	(154,317)
Change in cash and cash equivalents	**–**	(14,519)	**–**	(25,537)
Cash and cash equivalents – beginning of period	**–**	21,976	**–**	32,994
Cash and cash equivalents – end of period	**–**	7,457	**–**	7,457

See accompanying notes to the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

As at and for the period ended September 30, 2012
(unaudited)

1. Reporting Entity

DeeThree Exploration Ltd. ("DeeThree" or the "Company") is a publicly traded company incorporated under the laws of Alberta. The Company is principally engaged in the exploration for and exploitation, development and production of oil and natural gas, and conducts many of its activities jointly with others. These interim financial statements reflect only the Company's interests in such activities. DeeThree is registered and domiciled in Canada. The address of its main office is Suite 2200, 520 Third Avenue S.W., Calgary, Alberta.

2. Basis of Presentation

Statement of Compliance

These interim financial statements for the three and nine months ended September 30, 2012 are unaudited and have been prepared in accordance with International Accounting Standard ("IAS") 34 – "Interim Financial Reporting" using accounting policies consistent with IFRS.

The interim financial statements should be read in conjunction with the Company's annual audited financial statements for the year ended December 31, 2011.

The interim financial statements were authorized for issue by the Board of Directors on November 13, 2012.

3. Significant Accounting Policies

The Company's accounting policies are described in Note 3 to the December 31, 2011 audited annual financial statements. Those accounting policies have been applied consistently to all periods presented in these interim financial statements.

4. Acquisitions

During the first quarter of 2011, the Company acquired oil and gas assets principally located in the Peace River Arch area of northern Alberta and the Brazeau area of central Alberta for total cash consideration of $123,185,000. The property acquisition closed on March 22, 2011 and was accounted for as a business combination under IFRS 3 – "Business Combinations". Acquisition costs of $1,125,000 were charged to general and administrative expense on the statement of income and comprehensive income. Had the acquisition closed January 1, 2011, for the year ended December 31, 2011, the Company estimates that its pro forma revenue and net loss would have been approximately $39,200,000 and $13,064,000, respectively.

(000s)	*($)*
Net assets acquired	
Petroleum and natural gas assets	122,081
E&E assets	7,773
Adjustments related to January 1 to March 22, 2011 period	(1,815)
Decommissioning liabilities	(4,854)
	123,185
Consideration	
Total cash consideration	123,185

5. Exploration and Evaluation Assets

	Nine Months Ended September 30, 2012	Year Ended December 31, 2011
(000s)	*($)*	*($)*
Balance – beginning of period	**18,631**	11,052
Additions	**87,703**	57,010
Proceeds from farm-outs	**(1,000)**	(8,000)
Acquisitions through business combinations	**–**	8,249
Transfers to property and equipment	**(71,947)**	(41,693)
E&E expenses	**–**	(7,474)
Lease expiries	**(2,745)**	(513)
Balance – end of period	**30,642**	18,631

During the period ended September 30, 2012, an expense of $2,745,000 was recorded to recognize lease expiries on undeveloped land that occurred during the period (year ended December 31, 2011 – $513,000).

6. Property and Equipment

	Oil and Natural Gas Properties	Office Equipment	Total
(000s)	*($)*	*($)*	*($)*
Cost or deemed cost			
Balance – January 1, 2011	37,692	59	37,751
Acquisitions through business combinations	122,883	–	122,883
Additions	8,926	194	9,120
Transfers from E&E assets	41,693	–	41,693
Balance – December 31, 2011	211,194	253	211,447
Additions	**14,780**	**29**	**14,809**
Transfers from E&E assets	**71,947**	**–**	**71,947**
Balance – September 30, 2012	**297,921**	**282**	**298,203**
Accumulated depletion and depreciation			
Balance – January 1, 2011	19,970	23	19,993
Depletion and depreciation for the year	14,871	21	14,892
Balance – December 31, 2011	34,841	44	34,885
Depletion and depreciation for the period	**21,442**	**36**	**21,478**
Balance – September 30, 2012	**56,283**	**80**	**56,363**
Net book value			
December 31, 2011	176,353	209	176,562
September 30, 2012	**241,638**	**202**	**241,840**

(a) Capitalization of General and Administrative and Share-Based Compensation Expenses

During the nine months ended September 30, 2012, approximately $1,007,000 of directly attributable general and administrative expense and $851,000 of directly attributable share-based compensation expense were capitalized as expenditures on property and equipment (year ended December 31, 2011 – $884,000 and $576,000, respectively).

(b) Amortization and Impairment Charges

For the period ended September 30, 2012, management performed an assessment and determined that no impairment indicators existed as of September 30, 2012.

(c) Future Development Costs and Salvage Value

During the nine months ended September 30, 2012, an estimated $7,552,000 of future development costs associated with proved plus probable undeveloped reserves was included in the calculation of depletion and depreciation expense and an estimated $2,442,000 of salvage value of production equipment was excluded (December 31, 2011 – $44,747,000 and $2,791,000, respectively).

7. Bank Debt

At September 30, 2012, the Company had a revolving demand credit facility with an authorized borrowing base of $60,000,000 with interest charged at the bank's prime rate plus a range of 1.0% to 1.25% per annum based on the Company's consolidated debt to cash flow ratio. Standby fees associated with this facility range from 0.4% to 0.7% per annum on the undrawn portion of the facility, again based on the Company's consolidated debt to cash flow ratio. At September 30, 2012, $48,877,000 (December 31, 2011 – $8,521,000) was drawn against the revolving demand credit facility. The amount of the facility is subject to a borrowing base test performed on a periodic basis by the lenders, based primarily on reserves and using commodity prices estimated by the lenders as well as other factors. A decrease in the borrowing base could result in a reduction to the credit facility. Collateral for this facility consists of a general security agreement, providing a security interest over all present and after acquired personal property and a floating charge on all present and after acquired land interests of the Company.

Subsequent to the quarter end, in October 2012, the Company completed the funding of a new $90,000,000 revolving demand credit facility (the "New Credit Facility"). The New Credit Facility is provided by a syndicate of two new lenders replacing and paying out DeeThree's previously existing revolving demand credit facility.

8. Decommissioning Liabilities

The Company has estimated the net present value of decommissioning obligations to be $12,569,000 as at September 30, 2012 (December 31, 2011 – $10,363,000) based on an undiscounted total future liability of $16,350,000 (December 31, 2011 – $14,398,000). These payments are expected to be incurred over a period of one to 20 years with the majority of costs to be incurred between 2013 and 2026. At September 30, 2012, a risk-free rate of 2.5% (December 31, 2011 – 3.5%) and an inflation rate of 2% (December 31, 2011 – 2%) were used to calculate the net present value of the decommissioning liabilities.

	Nine Months Ended September 30, 2012	Year Ended December 31, 2011
(000s)	*($)*	*($)*
Balance – beginning of period	**10,363**	2,498
Liabilities incurred	**872**	538
Liabilities acquired	**–**	5,154
Revisions	**1,168**	2,055
Settlements	**(108)**	(116)
Accretion of decommissioning liabilities	**274**	234
Balance – end of period	**12,569**	10,363

9. Share Capital

(a) Authorized

Unlimited number of common voting shares, no par value.

Unlimited number of preferred shares, no par value, issuable in series.

(b) Issued – Common Shares

	Nine Months Ended September 30, 2012		Year Ended December 31, 2011	
	Shares	Amount	Shares	Amount
	(#)	*($000s)*	*(#)*	*($000s)*
Balance – beginning of period	**63,152,091**	**196,901**	32,937,091	73,530
Common shares issued *(i)*	**–**	**–**	27,195,000	116,602
Flow-through shares issued *(ii)*	**3,834,100**	**17,253**	3,000,000	15,450
Premium on flow-through shares *(ii)*	**–**	**(2,684)**	–	(2,550)
Exercise of options *(iii)*	**50,000**	**108**	20,000	58
Share issue costs	**–**	**(1,241)**	–	(8,283)
Tax benefit of share issue costs	**–**	**311**	–	2,094
Balance – end of period	**67,036,191**	**210,648**	63,152,091	196,901

(i) Common Share Issuances

In July 2011, DeeThree issued 400,000 common shares at a price of $3.46 per common share in exchange for approximately 12,800 net acres of undeveloped land located primarily in the Peace River Arch area of Alberta. Share issue expenses of approximately $7,000 were recorded in relation to this transaction and the value of the acquired land has been included in the Company's E&E balance at December 31, 2011.

In March 2011, DeeThree issued 26,795,000 common shares at a price of $4.30 per common share for total gross proceeds of $115,219,000 ($107,934,000 net of share issue expenses), including 3,495,000 common shares ($15,029,000) issued on the exercise in full of the underwriters' over-allotment option.

(ii) Flow-Through Share Issuances

In March 2012, DeeThree issued 3,834,100 flow-through shares at a price of $4.50 per flow-through share for total gross proceeds of $17,253,450 ($16,012,450 net of estimated share issue expenses), including 500,100 flow-through shares ($2,250,450) issued on the exercise in full of the underwriters' over-allotment option. The implied premium on the flow through shares of $0.70 per share or $2,683,870 was initially recorded as a liability on the statement of financial position and $2,210,000 remains at September 30, 2012. To date, the Company has incurred $3,044,450 of the total $17,253,450 of qualified exploration expenditures and the remainder will be spent by December 31, 2013.

In March 2011, DeeThree issued 3,000,000 flow-through shares at a price of $5.15 per flow-through share for total gross proceeds of $15,450,000 ($14,460,000 net of share issue expenses) and $0.85 per share or $2,550,000 was determined to be the implied premium on the flow-through shares. As at September 30, 2012, $nil of the flow-through share premium remains on the statement of financial position as a liability as the Company fulfilled this commitment for qualified exploration and development expenditures during the second quarter.

(iii) Options Exercises

On September 13, 2012, 50,000 options were exercised at a weighted average price of $1.20 per share for total cash proceeds of $60,000 and previously recognized share-based compensation expense of $48,000.

On January 6, 2011, 10,000 options were exercised at a weighted average price of $2.45 per share and on March 16, 2011, 10,000 options were exercised at a weighted average price of $2.29 per share for total cash proceeds of $48,000 and previously recognized share-based compensation expense of $10,000.

(c) Per Share Amounts

Per share amounts have been calculated on the weighted average number of shares outstanding. The basic and diluted shares outstanding were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s, except per share amounts)	*($)*	*($)*	*($)*	*($)*
Income (loss) for the period	**1,294**	(353)	**3,698**	(3,243)
	(#)	*(#)*	*(#)*	*(#)*
Weighted average number of common shares				
– basic	**66,995**	63,064	**65,772**	54,134
– diluted	**72,792**	63,064	**70,591**	54,134
	($)	*($)*	*($)*	*($)*
Net income (loss) per weighted average common share				
– basic	**0.02**	(0.01)	**0.06**	(0.06)
– diluted	**0.02**	(0.01)	**0.05**	(0.06)

10. Share-Based Compensation

The Company has an option program that entitles officers, directors, employees and certain consultants to purchase shares in the Company. Options are granted based on the five-day volume weighted average prior to the date of grant, vest 20% after six months and then 20% on the first, second, third and fourth anniversaries from the grant date and expire five years from the grant date.

The number and weighted average exercise prices of stock options are as follows:

	Nine Months Ended September 30, 2012		Year Ended December 31, 2011	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
	(#)	*($)*	*(#)*	*($)*
Outstanding – January 1	**4,382,200**	**2.89**	1,885,000	2.26
Issued	**1,515,058**	**3.86**	2,603,000	3.35
Exercised	**(50,000)**	**1.20**	(20,000)	2.37
Forfeited	**(50,644)**	**3.30**	(85,800)	3.00
Outstanding – end of period	**5,796,614**	**3.15**	4,382,200	2.89
Exercisable – end of period	**2,231,901**	**2.84**	1,177,900	2.57

The fair value of the common share purchase options granted was estimated as at the date of grant using the Black-Scholes option pricing model and the following weighted average assumptions:

Weighted Average Exercise Price	Options Outstanding	Weighted Average Contractual Life	Options Exercisable
($)	*(#)*	*(years)*	*(#)*
As at September 30, 2012			
1.20 – 1.99	**150,000**	**0.67**	**150,000**
2.00 – 2.99	**2,954,000**	**3.16**	**1,345,500**
3.00 – 3.99	**1,069,056**	**4.33**	**241,001**
4.00 – 4.99	**1,608,558**	**3.82**	**495,400**
5.00 – 5.30	**15,000**	**4.95**	**–**
	5,796,614	**3.50**	**2,231,901**

The fair value of the common share purchase options granted during the year was estimated as at the date of grant using the Black-Scholes option pricing model and the following weighted average assumptions:

As at	**September 30, 2012**	December 31, 2011
Risk-free interest rate *(%)*	**1.22**	1.48
Expected life *(years)*	**3.1**	2.1
Expected volatility *(%)*	**77**	77
Expected dividend yield (%)	**0**	0
Fair value of options granted during the year *($/share)*	**1.94**	1.39

A forfeiture rate of 1% for those options granted during the period ended September 30, 2012 (year ended December 31, 2011 – 0%) was used when recording share-based compensation expense. This estimate is adjusted to the actual forfeiture rate. Share-based compensation cost of $1,407,000 was expensed during the nine months ended September 30, 2012 (year ended December 31, 2011 – $1,030,000).

11. Supplemented Cash Flow Information

Changes in non-cash working capital is comprised of:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	**2012**	2011
(000s)	*($)*	*($)*	*($)*	*($)*
Accounts receivable	**(2,574)**	(3,098)	**(1,588)**	(8,156)
Prepaid expenses and other	**243**	(79)	**(204)**	(304)
Accounts payable and accrued liabilities	**9,219**	9,885	**14,233**	14,784
Abandonment and reclamation costs	**–**	(6)	**(108)**	(6)
	6,888	6,702	**12,333**	6,318
Related to operating activities	**(1,710)**	5,115	**1,457**	(1,393)
Related to financing activities	**–**	–	**50**	–
Related to investing activities	**8,598**	1,587	**10,826**	7,711
	6,888	6,702	**12,333**	6,318

12. Financial Risk Management

The Company has exposure to credit, liquidity and market risk. The Company's risk management policies are established to identify and analyze the risks faced by the Company, set appropriate limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

(a) Risk Management Contracts

The fair value of forward contracts is determined by discounting the difference between the contracted prices and published forward price curves as at the reporting date, using the remaining contracted oil and natural gas volumes and a risk-free interest rate (based on published government rates). The fair value of options is based on option models that use published information with respect to volatility, prices and interest rates.

DeeThree classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and bank debt included in the statement of financial position approximate fair value due to the short-term nature of those instruments or, in the case of bank debt, due to the interest rate applied. The fair value measurement of the derivative financial instruments has a fair value hierarchy of Level 2.

As at September 30, 2012, the Company had the following crude oil and foreign exchange risk management contracts in place with a total mark-to-market asset value of $1,668,000 ($1,398,000 current and $270,000 non-current):

Period	Commodity	Type of Contract	Quantity	Pricing Point	Contract Price
Jan.1/12 – Dec.31/12	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$95.00/bbl (floor) – US$115.00/bbl (cap) (1)
Jan.1/12 – Dec.31/12	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$85.00/bbl (floor) – US$112.50/bbl (cap) (2)
Jan.1/12 – Dec.31/12	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$90.00/bbl (floor) – US$116.60/bbl (cap) (3)
Jan.1/13 – Dec.31/13	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$85.00/bbl (floor) – US$111.00/bbl (cap) (4)
Jan.1/13 – Dec.31/13	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$90.00/bbl (floor) – US$113.25/bbl (cap) (5)
Jan.1/13 – Dec.31/13	Crude oil	Collar	250 bbls/d	WTI – NYMEX	US$90.00/bbl (floor) – US$116.25/bbl (cap) (6)
May 1/12 – Dec.31/13	Crude oil	Collar	250 bbls/d	WTI-NYMEX	US$95.00/bbl (floor) – US$118.00/bbl (cap) (7)
Sept.1/12 – Dec.31/12	Crude Oil	Collar	500 bbls/d	WTI-NYMEX	US$85.00/bbl (floor) – US$104.25/bbl (cap) (8)
Jan.1/13 – Dec. 31/13	Crude Oil	Swap	500 bbls/d	WTI-NYMEX	US$90.00/bbl (floor) – US$106.00/bbl (cap) (9)

(1) Unless the monthly WTI price averages over US$115.00/bbl every day for the entire month, in which case the cap becomes US$100.00/bbl.
(2) Unless the monthly WTI price averages over US$112.50/bbl every day for the entire month, in which case the cap becomes US$95.00/bbl.
(3) Unless the monthly WTI price averages over US$116.60/bbl every day for the entire month, in which case the cap becomes US$95.00/bbl.
(4) Unless the monthly WTI price averages over US$111.00/bbl every day for the entire month, in which case the cap becomes US$90.00/bbl.
(5) Unless the monthly WTI price averages over US$113.25/bbl every day for the entire month, in which case the cap becomes US$92.00/bbl.
(6) Unless the monthly WTI price averages over US$116.25/bbl every day for the entire month, in which case the cap becomes US$92.00/bbl.
(7) Unless the monthly WTI price averages over US$118.00/bbl every day for the entire month, in which case the cap becomes US$100.00/bbl.
(8) Unless the monthly WTI price averages over US$104.25/bbl every day for the entire month, in which case the cap becomes US$90.00/bbl.
(9) Unless the monthly WTI price averages over US$106.00/bbl every day for the entire month, in which case the cap becomes US$90.00/bbl.

Period	Currency	Type of Contract	Quantity	Pricing Point
Jan.1/12 – Dec. 31/12	US$	Average Rate Participating Forward	US$1,400,000	Strike – $1.0275 Fade In – $0.9300 Participating – $1.0800 (1)
Jan.1/12 – Dec.31/13	US$	Average Rate Range Bonus Accumulator	US$700,000	Target – $1.10 CDN$/US$ + $1,000 bonus/day (2)
Jun.1/12 – Dec.31/13	US$	Average Rate Range Bonus Accumulator	US$900,000	Target – $1.0775 CDN$/US$ + $900 bonus/day (3)

(1) If the Bank of Canada average daily noon rate ("average rate") for the month is equal to or greater than the fade in level and equal to or less than the strike, the Company is committed to sell U.S. dollars at the strike price. If the average rate settles greater than the strike and equal to or less than the participating level, no transaction occurs. If the average rate for the month settles above the participating level, the Company is obligated to settle at the strike price and if the average rate settles less than the fade in level, no transaction occurs.

(2) The Company can earn a bonus payout of up to $1,000/day depending on the period in which the exchange rate remains in the applicable range of equal to or greater than $0.9350 and equal to or less than $1.10.

(3) The Company can earn a bonus payout of up to $900/day depending on the period in which the exchange rate remains in the applicable range of equal to or greater than $0.9300 and equal to or less than $1.0775.

(b) Capital Management

The Company manages its capital to maintain its ability to continue as a going concern and to provide returns to shareholders and benefits to other stakeholders. The capital structure of the Company consists of cash and cash equivalents, bank debt and equity comprising of issued share capital, contributed surplus and deficit.

The following is a breakdown of the Company's capital structure:

As at	**September 30, 2012**	December 31, 2011
(000s)	*($)*	*($)*
Cash and cash equivalents	**–**	–
Bank debt	**48,877**	8,521
Shareholders' equity	**187,308**	167,568

The Company manages its capital structure and makes adjustments to it in light of economic conditions. In order to maintain or adjust capital structure, DeeThree may issue new common shares, issue new debt, adjust exploration and development capital expenditures or acquire or dispose of assets. In the second quarter of 2012, the Company increased its revolving demand credit facility to an authorized borrowing base of $60,000,000. During the first quarter of 2012, the Company issued 3,834,100 flow-through shares at a price of $4.50 per flow-through share, including 500,100 flow-through shares issued on the exercise in full of the underwriters' over-allotment option. During 2011, the Company issued 26,795,000 common shares at a price of $4.30 per share, 3,000,000 flow-through shares at a price of $5.15 per share and 400,000 common shares at a price of $3.46 per share in exchange for approximately 12,800 net acres of undeveloped land. The Company, upon approval from its Board of Directors, will balance its overall capital structure through new share issues, the issue of debt or by undertaking other activities as deemed appropriate under the specific circumstances.

DeeThree does not have any externally imposed financial covenants governing its capital structure. The current credit facility has no financial ratio covenants; however, there are certain covenants in the agreement with respect to restrictions to significantly altering the Company's capital structure without the approval of the lender.

The Company's overall strategy with respect to capital risk management remains unchanged from the year ended December 31, 2011.

13. Commitments

Years Ended December 31,	2012	2013	2014	2015+	Total
(000s)	*($)*	*($)*	*($)*	*($)*	*($)*
Operating lease – office	160	640	640	800	2,240
Operating lease – equipment	67	76	17	–	160
Exploration expenditures (flow-through)	–	19,214	–	–	19,214
Drilling contracts	1,625	5,121	–	–	6,746
Bank debt	48,877	–	–	–	48,877
Total	50,729	25,051	657	800	77,237

In connection with the issuance of flow-through shares by the Company during the first quarter of 2012, DeeThree is required to spend $17,253,450 of eligible exploration expenditures by December 31, 2013. As at September 30, 2012, $3,044,450 of these eligible exploration expenditures has been incurred. The remaining $14,209,000 of eligible expenditures will be incurred during 2012 and 2013. These expenditures will be renounced to shareholders in January 2013 effective December 31, 2012.

Subsequent to the quarter end, the Company issued an additional 770,000 flow-through shares and will be required to spend an additional $5,005,000 of eligible exploration expenditures by December 31, 2013. These expenditures will be incurred during 2013 and will be renounced to shareholders in January 2013 effective December 31, 2012.

In connection with the issuance of flow-through shares by the Company during the first quarter of 2011, DeeThree was required to spend $15,450,000 of eligible exploration expenditures by December 31, 2012. As at September 30, 2012, 100% of those eligible exploration expenditures have been incurred and the commitment has been fulfilled. These expenditures were renounced to shareholders in January 2012 effective December 31, 2011.

At September 30, 2012, the Company also had the obligation to repay the amount outstanding on the revolving demand credit facility, which was drawn to $48,877,000 at period-end. Subsequent to the quarter end, the Company completed the funding of a new $90 million revolving demand credit facility (the "New Credit Facility"). See Note 14 for additional information.

14. Subsequent Events

In October 2012, the Company completed the funding of a new $90,000,000 revolving demand credit facility (the "New Credit Facility"). The New Credit Facility is provided by a syndicate of two new lenders replacing and paying out DeeThree's previously existing revolving demand credit facility.

On October 4, 2012, the Company executed a purchase and sale agreement with a private oil and gas company pursuant to which DeeThree acquired interests in producing assets in the Brazeau Belly River area for cash consideration of $7,000,000 subject to certain adjustments.

On October 18, 2012, the Company issued 3,139,500 common shares at a price of $5.50 per common share, including 409,500 common shares ($2,252,250) issued on the exercise in full of the underwriters' over-allotment option and 770,000 flow-through shares at a price of $6.50 per flow-through share for total gross proceeds of $22,272,250 ($20,800,000 net of estimated share issue expenses). The proceeds of the share offering will be used to conduct development and exploration activity on the Company's Belly River formations on its lands in its Brazeau area as well as additional Alberta Bakken targets on the Lethbridge Property.

CORPORATE INFORMATION

Board of Directors

Michael Kabanuk
Executive Chairman
DeeThree Exploration Ltd.

Brendan Carrigy
Independent Businessman

Martin Cheyne
President & Chief Executive Officer
DeeThree Exploration Ltd.

Henry Hamm (1)(2)(3)
Independent Businessman

Dennis Nerland (1)(2)(3)
Partner
Shea Nerland Calnan LLP

Brad Porter (1)(2)(3)
Independent Businessman

(1) Audit Committee Member
(2) Reserves Committee Member
(3) Corporate Governance & Compensation Committee Member

Officers

Martin Cheyne
President & Chief Executive Officer

Gail Hannon
Chief Financial Officer

Trevor Murray
Vice President, Land

Clayton Thatcher
Vice President, Exploration

Daniel Kenney
Corporate Secretary

Casey Paulhus
Controller

Head Office

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Website:	www.deethree.ca

Auditors

KPMG LLP
Calgary, Alberta

Banker

National Bank of Canada
Calgary, Alberta

ATB Financial
Calgary, Alberta

Evaluation Engineers

Sproule Associates Limited
Calgary, Alberta

Legal Counsel

Davis LLP
Calgary, Alberta

Registrar and Transfer Agent

Olympia Trust Company
Calgary, Alberta

Stock Trading

Toronto Stock Exchange
Trading Symbol: DTX

OTCQX
Trading Symbol: DTHRF

Abbreviations

bbls	barrels
boe	barrels of oil equivalent
GJ	gigajoules
/d	per day
mbbls	thousand barrels
mboe	thousand barrels of oil equivalent
mcf	thousand cubic feet
mm	million
mmbtu	million British thermal units
mmcf	million cubic feet
NGLs	natural gas liquids

Conversion of Units

1,0 mcf	=	1.02 mmbtu
1.0 mcf	=	1.05 GJ
1.0 acre	=	0.40 hectares
2.5 acres	=	1.0 hectare
1.0 bbl	=	0.159 cubic metres
6.29 bbls	=	1.0 cubic metre
1.0 foot	=	0.3048 metres
3.281 feet	=	1.0 metre
1.0 mcf	=	28.2 cubic metres
0.035 mcf	=	1.0 cubic metre
1.0 mile	=	1.61 kilometres
0.62 miles	=	1.0 kilometre

Natural gas is equated to oil on the basis of 6 mcf : 1 bbl

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